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Politics this week

Sep 8th 2005
From The Economist print edition

Katrina's aftermath

AP

Over a week after Hurricane Katrina devastated America's Gulf coast, engineers started to plug the gaps in **New Orleans's** flood defences and began pumping water out of the devastated city. Any remaining residents were ordered to leave by the mayor as fears grew about the toxicity of the stagnant floodwaters. Meanwhile, politicians and officials at the federal, state and local level came under criticism for the slow response to the disaster; George Bush asked Congress for $52 billion in extra relief. The death toll in Louisiana and Mississippi was surmised to be many thousands.

See article

William Rehnquist, the chief justice of the **Supreme Court** since 1986, died after a long battle against thyroid cancer. Mr Bush proposed that John Roberts, whom he previously nominated to fill the vacancy created by Sandra Day O'Connor's retirement, be elevated to the top slot. Mr Roberts's Senate confirmation hearings, which were due to start this week, were delayed until September 12th.

See article

California's legislature became the first in America to pass a bill legalising **gay marriage**. The measure, which had been defeated in June, now goes to Governor Arnold Schwarzenegger, who has said he will veto it.

Paul Volcker, a former head of the Federal Reserve, issued the findings of an investigation into the UN's **oil-for-food programme** in Iraq, finding it to have been riddled with graft and incompetence. Kofi Annan, the UN secretary-general, admitted that the report had shone “a harsh light” at “unsightly corners” but did not offer to resign.

See article

Vintage Vicente

In his final state-of-the-union address to Congress before next year's elections, **Mexico's** president, Vicente Fox, said he had broken the country's cycle of economic collapses and urged congressmen to back his long list of promised but undelivered reforms.

See article

Widespread protests over rising energy prices swept **Jamaica** as Caribbean leaders gathered

there to sign a cut-price oil deal with Venezuela's president, Hugo Chávez.

One of the **Caribbean's** most prominent politicians, Eugenia Charles—Dominica's formidable former prime minister, best remembered for backing America's controversial 1983 invasion of Grenada—died at the age of 86.

Eight candidates have registered to run for the unenviable job of president of **Bolivia**, where violent protests have driven out two presidents since 2003. So far the front-runners for December's vote are Jorge Quiroga, a conservative ex-president, and Evo Morales, a coca-growers' leader.

Getting to know you

India's prime minister, Manmohan Singh, held a meeting in Delhi with a group of Kashmiri separatists, the first time an Indian prime minister has done so.

See article

Tony Blair, acting on behalf of the European Union, signed a **co-operation agreement with India**. It covers trade, security, climate change, and research and development.

Reuters

The **Philippines'** Congress voted not to impeach the country's president, Gloria Macapagal Arroyo.

See article

Nepal's Maoists signed a three-month ceasefire with the government. Observers suspected it was in part designed to force the king to relinquish some of the absolutist powers he gave himself in last February's “royal coup”.

See article

Reporters Without Borders, a human-rights group, accused Yahoo! of supplying information to the **Chinese** government that led it to jail a journalist for publishing a Communist Party document. The internet company refused to comment.

L'état, c'est moi

The 72-year-old French president, **Jacques Chirac**, was treated in hospital for what was described as an “eye problem”. His illness sparked renewed competition between the prime minister, Dominique de Villepin, and the interior minister (and young pretender), Nicolas Sarkozy, to be seen as heir apparent.

See article

After the resignation of key officials amid a corruption scandal, **Ukraine's** president, Viktor Yushchenko, dismissed the government of Yulia Timoshenko and asked Yuri Yekhanurov, a regional governor, to become prime minster.

See article

The European Union's 25 members failed to agree on a common stance towards **Turkey**, which expects to start full membership talks in October. **Cyprus** asked for an emergency EU ministerial meeting ahead of the talks to discuss Turkey's refusal to recognise it.

The **German election** campaign continued. Chancellor Gerhard Schröder met his rival Angela Merkel in a one-on-one TV debate, which polls said Mr Schröder had won. Many pundits thought Ms Merkel had done enough to stay on course for victory.

See article

Russia's president, **Vladimir Putin,** again ruled out a constitutional change that would allow him to stand for a third term in 2008. But with 60% of Russians wanting him to stay on, Mr Putin may yet change his mind.

Out of many, one

Reuters

For the first time in their history, **Egyptians** were given a choice of candidates (nine, in all) in a presidential election, which the 77-year-old incumbent for the past 24 years, Hosni Mubarak, seemed bound to win.

See article

The International Atomic Energy Agency, the UN's nuclear guardian, confirmed that **Iran** had resumed work at its uranium-conversion plant at Isfahan, which breaks an agreement with the Europeans to suspend it. But several countries, notably Russia, balked at the EU and American suggestion that Iran be referred to the UN Security Council.

See article

Musa Arafat, a former head of **Palestinian** military intelligence and a cousin of the late Yasser Arafat, was killed by unknown assailants in Gaza, further undermining the Palestinian Authority.

See article

Two car-bombs in Basra, **Iraq's** biggest southern city, killed 16 Iraqis and four Americans—the city's worst day of violence for at least a year.

The UN's man in **Côte d'Ivoire** announced this week that it would be impossible to hold the election scheduled for October 30th. The northern rebels and other militias have failed to disarm, and the government has made virtually no preparations to hold a poll that many hoped would peacefully resolve the country's civil war.

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Business this week

Sep 8th 2005
From The Economist print edition

Fazio under fire

Antonio Fazio, the governor of **Italy's central bank**, came under intense pressure to resign. Both Italy's finance minister and deputy prime minister led calls for Mr Fazio to go because of his alleged intervention and favouritism in a highly contested battle between an Italian and a Dutch bank to take over Banca Antonveneta. Last week, the government backed a reform plan for the Bank of Italy that includes ending the lifetime appointment of governors.

See article

Julius Baer, one of Switzerland's leading financial institutions, bought three banks and an investment firm from **UBS** for SFr5.6 billion ($4.5 billion). The firm wants to expand in Asian and Middle Eastern markets. More consolidation is expected in Switzerland's fragmented private banking sector.

See article

Endesa, Spain's biggest energy group, rejected a *euro*22.5 billion ($28.1 billion) takeover offer by **Gas Natural**, a smaller rival that proposed selling some of Endesa's assets to help finance its deal. Meanwhile, **E.ON**, a German utility group, confirmed it was interested in buying **Scottish Power**. The bids are the latest moves at consolidation among European energy firms before 2007 when the region's retail energy market is set to be fully liberalised.

See article

Amid fears of new global pandemics, big drug firms are trying to expand their stakes in the vaccine business. This week **GlaxoSmithKline** agreed to buy ID Biomedical, a Canadian vaccine-maker, for $1.4 billion. **Novartis's** $4.5 billion takeover bid was rejected by independent directors at **Chiron**, a Californian vaccine firm in which Novartis already has a 42% stake.

Industrial action

A bad week for **Boeing**. Machinists went on strike over benefits in a new contract. The last machinists' strike at Boeing lasted for 69 days in 1995. Boeing's arch-rival **Airbus** announced that China Southern Airlines, one of China's biggest, had bought ten Airbus A330 aircraft for $1.5 billion.

In direct competition to Boeing, **Northrop Grumman** said it will team up with **EADS**, Airbus's parent company, to compete for the Pentagon's air-refuelling tanker contract, worth up to $100 billion over 30 years.

BMW is to join **DaimlerChrysler** and **General Motors** in a project that develops new hybrid

technologies for vehicles. Japanese carmakers, which lead the market for petrol-electric cars, have seen sales soar recently in America as consumers look for ways to reduce their fuel costs.

See article

In the third big shipping merger this year, **CMA CGM**, France's largest container-shipping line, said it had agreed the terms of its takeover of **Delmas**, a rival group specialising in routes to Africa, for $600m. The new company passes Taiwan's Evergreen to become the world's third-biggest shipper.

Microsoft asked a court in Washington state to halt a former executive's employment by **Google**. Kai-Fu Lee joined Google in July to oversee its development in China. Microsoft argues that he knows intimate details of its Chinese operations.

Anticipating a wave of new competition for its popular iPod, **Apple Computer** unveiled a mobile-phone handset, made by Motorola, which can play music from its iTunes online music store.

Another victory for attempts to stem **illegal file-swapping** over the internet. A court in Australia ordered the owners of Kazaa Media Desktop, Sharman Networks, of Sydney, to amend the software so that it does not allow the downloading of copyrighted music or film.

PartyGaming, the internet's leading poker site, saw its share price fall by 33% after it revealed that new customer growth and spending by players had slowed more than anticipated, worrying investors that the online gaming boom may be ending.

The EU reached a deal with China on **textile imports** that releases millions of garments impounded in Europe's warehouses because quotas have been filled. At a meeting in Beijing, the EU and China agreed that half the backlog could count towards next year's quota.

See article

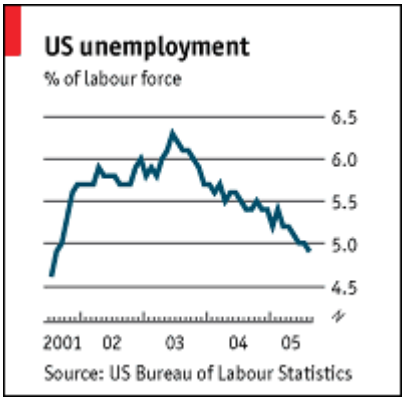
Oil prices fell back from last week's all-time high and traded at around $65 per barrel. However, analysts feared that the damage wrought by Hurricane Katrina might mean further price increases.

See article

You can expect a rise

America's **unemployment rate** fell to 4.9% in August, the lowest it has been since August 2001. However, the good news was overshadowed by a gloomy prediction from the CBO about Hurricane Katrina's impact on the labour market: 400,000 jobs may be lost by the end of the year.

See article



Hurricane Katrina

The shaming of America

Sep 8th 2005
From The Economist print edition

Hurricane Katrina has exposed both personal and structural weaknesses in America's government

EPA

EVEN America's many enemies around the world tend to accord it respect. It might be arrogant, overbearing and insensitive—but, by God, it can get things done.

Since Hurricane Katrina, the world's view of America has changed. The disaster has exposed some shocking truths about the place: the bitterness of its sharp racial divide, the abandonment of the dispossessed, the weakness of critical infrastructure. But the most astonishing and most shaming revelation has been of its government's failure to bring succour to its people at their time of greatest need.

The finger-pointing is already under way, with the federal government blaming local government and local government blaming the feds. But if America is to avoid future catastrophes it needs to do more than bicker. It needs to learn the right lessons from this fortnight's debacle.

Blame for the shame

Natural disasters on this scale inevitably bring chaos and suffering. Katrina wreaked havoc over an area the size of Britain. And even the best-laid hurricane plans cannot deal with the quirks of human nature. People who live in areas prone to hurricanes tend to become blasé about storm warnings. This insouciance is native to New Orleans, where a lethal local cocktail is called The Hurricane. But none of that excuses government's failure.

Local government must shoulder some of the blame. The authorities in Louisiana have a

reputation for confusion, inefficiency and worse. Different authorities are responsible for different levees, for example, and several close associates of the former mayor were recently indicted for corruption. Local incompetence exacerbated the disaster: in Orleans Parish, for instance, where 60,000 households do not own a car, hundreds of city buses which might have shipped out stranded people were left to be swamped by the rising waters.

Still, Washington is mostly at fault. The responsibility for mobilising the response to a disaster lies squarely with the federal government. And the responsibility for galvanising the federal government lies squarely with the president.

The administration's initial response recalled Donald Rumsfeld's reaction to the anarchy in Iraq: stuff happens. George Bush was listless and confused. Dick Cheney, the vice-president, remained on holiday in Wyoming. Condoleezza Rice, the highest ranking black in the country, saw a Broadway show, “Spamalot”, while New Orleans's poor looked out at the floodwaters. Mr Bush then added disingenuity to leaden-footedness, declaring that nobody had anticipated the breaching of the levees—even though people have been worrying about the possibility for years and an official report published in 2001 warned of impending disaster.

Mr Bush's personal weakness is shaming; but the structural failures in government that Katrina has revealed are perhaps more worrying. After September 11th Mr Bush poured billions into creating the Department of Homeland Security, but the department has flunked its first big test. It is a bureaucratic monstrosity that includes organisations as different as the Coast Guard and the immigration authorities and spends most of its energies in perpetual reorganisation. The department's focus on fighting terrorism has also distracted attention from coping with natural disasters, reducing the Federal Emergency Management Agency (FEMA) from a cabinet-level agency into a neglected stepchild. The best illustration of this is its boss: Michael Brown spent nine years at the Arabian Horse Association, before finally being eased out and joining FEMA as general counsel, brought in by its previous head, his college room-mate.

The second structural problem is Washington's addiction to pork-barrel spending. The anti-war left is keen to blame the Iraq war for depleting government's resources. The real problem, however, is not a lack of resources—Mr Bush has increased discretionary spending faster than any president since Lyndon Johnson—but the way they are allocated. The funding for New Orleans's levees, which has fallen by nearly half over the past four years, started dropping in 2001—before the Iraq war, but after Bob Livingston, a Louisiana congressman and erstwhile chairman of the House Appropriations Committee, left politics under a cloud. The recent transport bill contains some $24 billion-worth of pure pork—including $231m for a “bridge to nowhere” in Alaska. Although this sort of thing is endemic in Washington, it has got far worse since the Republicans took over both the White House and Congress.

Out of the depths

The polls suggest that the majority of people don't hold Mr Bush personally responsible for the bungling. Things are slowly improving on the ground. The federal government is pouring resources into the region, and ordinary Americans are opening their wallets to charities and their homes to refugees. But if Mr Bush is to rise to this occasion he needs to do more than take charge. He needs to make sure that America is better prepared for future calamities. This means rejigging his second-term agenda: downplaying favourite issues like Social Security reform and fixing the flaws in America's government that Katrina has exposed.

The most urgent task is to address the mess that is the Department of Homeland Security. He should upgrade FEMA and re-examine the wisdom of bundling disaster relief with terrorism prevention. He needs to confront the corrupt legislative culture in Washington: the job of the

president is to look to the national interest rather than to reward his friends. If he managed to persuade Congress to regurgitate the pork in the transport bill, that would go a long way towards paying for rebuilding the levees. And he needs to start wielding his red pencil and exercising his right to veto bad legislation.

If Mr Bush addresses America's failings with the same vigour that he addressed Islamic terrorism in the wake of September 11th, he has a chance of reinvigorating his presidency and restoring respect in his country; if he doesn't, he will go the way of his father, limping wounded into retirement.

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Economist.com OPINION

Trade

Storm in a D-cup

Sep 8th 2005
From The Economist print edition

Peter Mandelson does not emerge well from the bra wars

Reuters

SAY what you like about Peter Mandelson—and few people can resist the temptation—he has certain virtues. He is clever, he has keen political instincts and he has been on the right side (in both senses) of the big ideological debates within the European left. So when Mr Mandelson, who had been forced to resign twice from ministerial jobs in Britain in odd circumstances, arrived in Brussels last year to take up his new job as the European Union's trade commissioner, the opportunity to re-build his reputation was clear: the new trade commissioner seemed sure to emerge as one of the stars of the lacklustre European Commission led by José Manuel Barroso.

Less than a year into his job, however, Mr Mandelson is in danger of turning into an embarrassment. His intentions when he arrived in Brussels were clear and encouraging. In a city in which anti-Americanism and anti-capitalism are all too common, Mr Mandelson would be the voice of Atlanticism and liberal economics. And in a commission desperately short of political heavyweights, he would be a shrewd and experienced operator. Unfortunately, the new trade commissioner's actions over the past six months seem to have been almost designed to debunk each of these points. First, he got involved in a bout of bad-tempered name calling with Robert Zoellick, then his American counterpart (the two men are still squabbling over who slammed the phone down on whom). After that, he besmirched his reputation for economic liberalism by negotiating a protectionist deal to restrict Chinese textile exports to the EU. Finally, he took a pick-axe to his reputation for competence, when the textile deal that he had hailed as a “win, win, win agreement” came unstuck within weeks. With 80m pieces of imported Chinese clothing stacking up in European warehouses—and retailers terrifying the women of Europe with predictions of an impending shortage of bras—Mr Mandelson had to rush back to Beijing to re-negotiate.

After the traditional “gruelling all-night negotiating sessions”, the two sides came up with a complicated fix that should unblock Europe's warehouses. With the deal done, Mr Mandelson set about trying to rescue his reputation for economic liberalism, by giving a speech in Beijing billed as a “passionate defence of free trade”. Unfortunately, against the background of recent events, it was rather like hearing a passionate defence of marital fidelity from Bill Clinton: the sentiments are admirable, but the words somehow lack conviction.

So what went wrong? There is no doubt that Mr Mandelson was under intense political pressure from powerful lobbies in Europe, backed by the French and Italian governments. He is certainly not the first trade representative to be put in the uncomfortable position of defending a policy that goes against his best instincts—one recalls his foe, Mr Zoellick, trying to defend American steel tariffs. But Mr Mandelson also made serious errors of judgment. After his unnecessary row with the Americans, he was desperate to give a virtuoso display of his negotiating skills—a deal with the Chinese, any deal, fitted the bill all too neatly. Aware that he is regarded with deep suspicion in France, he was also too eager to shore up his political position by pandering to French protectionism. But, as the chastened commissioner remarked in Beijing this week, the trouble with managed trade deals is that “the law of unforeseen consequences will inevitably kick in.” With any luck, one of those unforeseen consequences will be to discredit any further attempts to “manage” European trade with China.

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The United Nations

The oil-for-food fiasco

Sep 8th 2005
From The Economist print edition

Even though the programme was corrupt and mismanaged, Kofi Annan should keep his job

AFP

Get article background

KOFI ANNAN, the secretary-general of the United Nations, said he wanted next week's summit of 170-plus heads of state and government in New York to be another “San Francisco moment”—a chance to recapture the spirit of renewal and optimism that accompanied the birth of the United Nations in California 60 years ago. He is not likely to get his way.

After more than a year of investigation, Paul Volcker, a former head of America's Federal Reserve, chose this of all weeks to publish his report on what went wrong with the UN's oil-for-food programme in Iraq. It does not make pretty reading. The programme achieved its basic aim, which was to allow an Iraq under sanctions to sell some oil so that some of the basic food and medical needs of its people could still be met. But Mr Volcker's team confirms that the programme was riddled with waste, inefficiency and corruption, including among UN staff at headquarters as well as in the field. As a result, Saddam Hussein's regime succeeded in squeezing a total illicit income of some $10 billion from the scheme, about $8 billion from smuggling and the rest from surcharges and kickbacks.

Ever since the Security Council failed to endorse the war against Iraq, Mr Annan's critics have been calling for him to resign or be sacked for his part in the oil-for-food programme. They have had two arguments. One is that he is himself guilty of malfeasance. The other is that even if he isn't, he was the man at the top and should therefore take the blame for a scandal that unfolded on his watch. On both counts, a case can be made that the Volcker report offers him an escape.

On the first count, Mr Volcker has found no evidence at all that the secretary-general himself did

anything corrupt, even though several people close to him plainly did.

On the second, the report does not say whether Mr Annan should go for having presided over such chaos and venality. It does say that corruption down the line reflected the absence of “a strong organisational ethic” that should have permeated the leadership. But it also argues that Mr Annan was not responsible for everything that went wrong. Though nominally the UN's administrative boss, neither he nor his predecessors were chosen for managerial skills or provided with the tools—such as the ability to hire and fire without political interference—to be effective managers. In the case of oil-for-food, the Security Council tried to keep control through a sanctions committee of national diplomats. Having neither the Security Council nor the secretariat in clear command was a recipe for “the evasion of responsibility at all levels”.

If the UN were a company whose boss had made a hash of things, *The Economist* would call for the top man's head. Removing a boss is a good way for shareholders to show that they want change. But since the UN is not a firm, sacking Mr Annan over the oil-for-food programme would send the wrong signal: that it is his person and not—as the Volcker report stresses—the structure of the organisation that is at the root of the problem. And because the UN is a political organisation, ousting Mr Annan would send a political signal, too. It would be read by many UN members as a punishment inflicted on the UN by America's more strident Republicans as revenge for the Security Council's failure to support the British and American invasion of Iraq in 2003.

A misbegotten vendetta

This paper supported the invasion of Iraq and lamented the failure of France and Russia to do so too. But France and Russia bear the responsibility for that decision, not the secretary-general, who in such cases is allowed to do only as much as the Security Council authorises, and can do nothing at all when his masters fall out. For all his failings over oil-for-food, Mr Annan behaved in a proper, neutral fashion over the war and should not be the fall guy for America's failure to muster an international consensus in its favour. Turning the secretary-general into a scapegoat would be bad at the best of times, but much worse now, when the UN is coming to terms with the arrival in New York of John Bolton, an abrasive new American ambassador to the UN with a famously dim view of the organisation, and on the eve of a summit at which the member states will be arguing about some of the biggest reforms it has contemplated since the UN's founding (see article).

Mr Annan is not the best secretary-general the UN has had. His failings as a manager have been cruelly exposed. But he has virtues as a diplomat and continues to enjoy the confidence of most of the organisation's members. He should be allowed to serve until his term ends in December 2006.

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Economist.com OPINION

Democracy in the Middle East

Lessons from Egypt

Sep 8th 2005
From The Economist print edition

America's campaign for democracy is struggling ahead. It needs wider support

AFP

IF PYRAMIDS could fly, there might have been a chance of Hosni Mubarak, after 24 years as Egypt's dictator, being voted out of pharaonic power in his country's first-ever multi-candidate presidential election this week. A time-wasting *son et lumière* under the gaze of a sphinx, then? Not at all. The germ of open political debate, if not of unfettered democracy, is in the air. Demands for more freedom, more choice and more accountability are ever louder, in Egypt and elsewhere in the region. For reasons of Egyptian pride and American tact, both sides pretend that the idea of allowing other candidates to stand against Mr Mubarak was Egypt's. But the plain fact is that without American's nagging, Mr Mubarak would never have considered for a second that he should let himself be challenged at the polls for the top job. However clumsy in its promotion and debatable its motives, America's campaign for democracy in the Middle East is making progress.

For sure, Egypt's election will have been only partially fair. If Mr Mubarak had faced the slightest risk of defeat, he would have refused to let serious contenders run against him. The state-controlled media paid only grudging heed to his opponents. The hardly independent electoral commission obstructed would-be monitors, from home and abroad. The Islamist-minded Muslim Brotherhood stayed banned, though it probably represents the strongest strain of popular opposition. Other prominent dissidents refused to take part. All the same, Mr Mubarak had to come out of his lair to explain himself as never before. Brave dissenting voices have been heard. It will be harder now for the government to shut them up.

Elsewhere in the Arab world, democracy is edging ahead, however messily. Lebanon, albeit under a sectarian quota system, has converted people's street power into parliamentary elections that have drastically reduced the influence of Syria, whose army has withdrawn and whose own regime is under pressure to reform or go. Bloody as it is, Iraq is groping towards a new constitutional and federal order that may, with luck, be endorsed in a referendum next month, to be followed by fresh elections by the end of the year. Despite being under Israeli occupation, the Palestinians

have freely chosen a new leader in elections this year and will soon pick a new parliament. The Arabs' more benevolent monarchs, notably in Morocco, Jordan and Gulf states such as Qatar and Bahrain, are moving tentatively towards more representative forms of government, though none is likely soon to give up final power.

Uncle Sam, the neighbourhood nag

How nice. And yet, across the Arab world, people do not seem as pleased—let alone grateful—as George Bush would like. America's motives are still held in the deepest suspicion. Educated and unlettered Arabs alike still tend to think America is driven by a thirst for cheap oil, a hatred of Islam, a loathsome bias in favour of Israel, and a hypocritical readiness to back dictators when it suits them. Its campaign for democracy is still widely derided as opportunistic and insincere.

It will take a long time for America to shed this incubus of mistrust. And, in one way, its motives are indeed selfish. Right or wrong, the United States concluded after September 11th 2001 that its own long-term security depended on ending the system of autocracy in the Middle East, which it believes encourages terrorism to breed. This history-changing project cannot be implemented at the stroke of a superpower's hand, for fear of plunging allies such as Egypt and Saudi Arabia into chaos. Nor is it a programme that the autocrats themselves can be expected to support with gusto, even though—as in Egypt—they can be nagged, nudged and shamed in the right direction.

Democracy, moreover, is not just about elections. It requires political institutions and civil society, an independent judiciary and press, checks and balances, tolerance and debate. Nurturing all of this will take time; and not even America could impose such changes on people who did not support them. Fortunately, these are things which most Arabs tell pollsters they want too, whatever their leaders say. So although this week's election was still a sham, in that Mr Mubarak's victory was stitched up in advance, it was the most open Egypt has ever had. America should continue to nag.

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Economist.com OPINION

Universities

How Europe fails its young

Sep 8th 2005
From The Economist print edition

The state of Europe's higher education is a long-term threat to its competitiveness

THOSE Europeans who are tempted, in the light of the dismal scenes in New Orleans this fortnight, to downgrade the American challenge should meditate on one word: universities. Five years ago in Lisbon European officials proclaimed their intention to become the world's premier “knowledge economy” by 2010. The thinking behind this grand declaration made sense of a sort: Europe's only chance of preserving its living standards lies in working smarter than its competitors rather than harder or cheaper. But Europe's failing higher-education system poses a lethal threat to this ambition.

Europe created the modern university. Scholars were gathering in Paris and Bologna before America was on the map. Oxford and Cambridge invented the residential university: the idea of a community of scholars living together to pursue higher learning. Germany created the research university. A century ago European universities were a magnet for scholars and a model for academic administrators the world over.

But, as our survey of higher education explains, since the second world war Europe has progressively surrendered its lead in higher education to the United States. America boasts 17 of the world's top 20 universities, according to a widely used global ranking by the Shanghai Jiao Tong University. American universities currently employ 70% of the world's Nobel prize-winners, 30% of the world's output of articles on science and engineering, and 44% of the most frequently cited articles. No wonder developing countries now look to America rather than Europe for a model for higher education.

Why have European universities declined so precipitously in recent decades? And what can be done to restore them to their former glory? The answer to the first question lies in the role of the state. American universities get their funding from a variety of different sources, not just government but also philanthropists, businesses and, of course, the students themselves.

European ones are largely state-funded. The constraints on state funding mean that European governments force universities to “process” more and more students without giving them the necessary cash—and respond to the universities' complaints by trying to micromanage them. Inevitably, quality has eroded. Yet, as the American model shows, people are prepared to pay for good higher education, because they know they will benefit from it: that's why America spends twice as much of its GDP on higher education as Europe does.

The answer to the second question is to set universities free from the state. Free universities to run their internal affairs: how can French universities, for example, compete for talent with their American rivals when professors are civil servants? And free them to charge fees for their services—including, most importantly, student fees.

Asia's learning

The standard European retort is that if people have to pay for higher education, it will become the monopoly of the rich. But spending on higher education in Europe is highly regressive (more middle-class students go to university than working-class ones). And higher education is hardly a monopoly of the rich in America: a third of undergraduates come from racial minorities, and about a quarter come from families with incomes below the poverty line. The government certainly has a responsibility to help students to borrow against their future incomes. But student fees offer the best chance of pumping more resources into higher education. They also offer the best chance of combining equity with excellence.

Europe still boasts some of the world's best universities, and there are some signs that policymakers have realised that their system is failing. Britain, the pacemaker in university reform in Europe, is raising fees. The Germans are trying to create a Teutonic Ivy League. European universities are aggressively wooing foreign students. Pan-European plans are encouraging student mobility and forcing the more eccentric European countries (notably Germany) to reform their degree structures. But the reforms have been too tentative.

America is not the only competition Europe faces in the knowledge economy. Emerging countries have cottoned on to the idea of working smarter as well as harder. Singapore is determined to turn itself into a “knowledge island”. India is sprucing up its institutes of technology. In the past decade China has doubled the size of its student population while pouring vast resources into elite universities. Forget about catching up with America; unless Europeans reform their universities, they will soon be left in the dust by Asia as well.

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Letters

Sep 8th 2005
From The Economist print edition

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Dealing with jihadists

SIR – Your report comparing anarchists in the 19th century with today's Islamic terrorists failed to note the counterproductive laws that were implemented after the assassination in 1881 of Tsar Alexander II, Russia's most progressive leader since Peter the Great ("For jihadist, read anarchist", August 20th). After Alexander II's death, Alexander III and Nicholas II revoked a great many of his reforms that were designed to bring Russia in line with European standards of justice, seen at the time as necessary to encourage industrialisation. This turnaround on reform embittered and emboldened the very people the post-assassination measures were designed to stop, feeding the revolutions of 1905 and 1917. While today's western nations are probably not at risk of becoming fundamentalist Islamic states, they should still keep Russian history in mind. Legislation that may seem expedient today is likely to have unintended consequences tomorrow when we find that we have compromised who we once were.

Charles Paul Hoffman
New York

SIR – Osama bin Laden and the anarchists who preceded him are hardly unique when it comes to justifying the slaughter of civilians to further their goals. Sovereign governments have long made a practice of "total war"; not least the allies in the second world war whose bomber pilots had little difficulty rationalising the destruction of civilian homes after the strategic targeting of military and industrial installations became too difficult. Sir Arthur "Bomber" Harris justified it at the time by noting it was better to drop a bomb anywhere in Germany than none at all. When we go to war, whether as part of a nation-state or as part of a disaffected minority, we commit ourselves to the atrocity of murder. Whether we confine ourselves to hitting "legitimate" targets at that point is merely a matter of semantics. All nations have done this and will do so again when they feel the need to. Moralising against those who return the favour is as much human nature as it is hypocrisy.

Bill Coffin
Oakhurst, New Jersey

SIR – The anarchist creed was one that sought to disempower government through a war on society's institutions, which explains the large number of assassinations of high-ranking officials in the 19th century. Unlike jihadists, anarchists did not target innocent civilians purely for the sake of striking fear into the hearts of the populace or to display their ambition. Moreover, anarchists had to meet and organise underground and did not have the monetary, military and moral support of several governments, which jihadists do. To combat today's jihadist needs a very different method to combating 19th-century anarchists.

Adam Friedman

Brookline, Massachusetts

Bra wars

SIR – The sight of China's clothing imports piling up at Europe's borders is reminiscent of what economies in the West did in the 1980s to block the import of cars from Japan ("Knickers in a twist", August 27th). Those who think that these curbs will revive Europe's ailing textile industry are sadly mistaken. Look at Manchester, once the citadel of Britain's textile prowess, which is now enshrined in the yellow pages of textile history. The main reason for this decline is the wide disparity in wages between workers in China and the West, which means western economies can only fight a losing battle by trying to stop imports.

M.M. Gurbaxani
Bangalore, India

Paying at the pump

SIR – Your leader on oil fails to explain how a higher petrol tax in America, resulting in higher oil prices, would cause a change in consumer behaviour ("The oiloholics", August 27th). American consumers, who commute and travel over large distances and are dependent on their cars, are not happy with high oil prices in the short run. They would be even unhappier (as in "Vote the bums out!") when confronted by permanently high oil prices stemming from a new taxation policy. When asked recently what OPEC was doing to lower oil prices, an oil minister responded that western countries could instantly lower prices to the consumer by removing the excessive high taxes on oil. Now that has a populist appeal which American consumers are more likely to sympathise with.

Branko Terzic
Global regulatory policy leader for energy and resources
Deloitte Services
McLean, Virginia

SIR – The problem of high oil prices is not one of high demand but of a politically strangled supply. High prices normally send out two signals in free markets: they tell consumers to use less and producers to supply more. Prices eventually fall as a result of this decreased demand and increased supply. However, many oil producers are incapable of increasing their supply because of ridiculous environmentalist policies promulgated by politicians.

The cover page of your "oiloholics" issue illustrated two dumb, fat consumers of oil. Instead, what you should have depicted are two skinny, scrawny environmental hippies with "love" and "peace" tattoos on their arms, strangling oil wells and preventing access to huge reserves of oil below their feet. A supply shortage is the issue and politicians are the problem. Not until they ignore environmentalists and allow market forces to work unmolested can oil suppliers act upon the signal that high prices send to their industry—pump, refine and deliver more.

David Dahan
Allentown, Pennsylvania

Out of Malaysia

SIR – Your analysis of Malaysia's racial preferences does not consider their impact on ethnic Chinese emigration. ("Failing to spread the wealth", August 27th). As a Fulbright scholar in Singapore, I met highly qualified Chinese Malaysians who were refused entry into Malaysia's

universities and emigrated with little intention of returning. While the “Malay professional class has grown rapidly from a negligible base” on a percentage basis, in real terms the size of the whole of the professional class could have been larger without affirmative action.

Ron Davidson
Washington, DC

Spelling caper

SIR – In your article on the United States' growing penchant for goat meat, you name a Hispanic dish made of young goat as *capretto* (“No kidding”, August 27th). The correct term in (Mexican) Spanish is *cabrito—capretto* is the Italian term. What fancy Manhattan restaurants call it is anybody's guess.

Claudine Wiley Cellier
Paris

Using the five-letter word

SIR – The Vikings were unilateral traders and didn't leave much in their wake except pregnant women and a few swear words (“Wash your mouth out”, August 13th). Nevertheless, you didn't mention that current usage of the Swedish word *focka* would not designate it as a dirty word today. *Focka* means “to sack someone” from their job. The Swedish vulgarism for copulation is *fucka*, similar to the Norwegian *fukka*.

Jan Karlen
Finspang, Sweden

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Economist.com SPECIAL

Katrina's aftermath

When government fails

Sep 8th 2005 | AUSTIN, NEW ORLEANS, ST PAUL AND WASHINGTON, DC
From The Economist print edition

AP

The pathetic official response to Katrina has shocked the world. How will it change America?

ONLY those with a special pass, and under armed guard, can now go to the centre of New Orleans. The city, officials will tell you, is far more dangerous than is generally believed. But just a few people, such as scientists needing to retrieve experiments, are being allowed in.

Much of the city is a sea of filthy water. Cars, boats, trees and power-lines float on it in a tangled mass. The water stinks. On higher ground some parts remain oddly untouched, save for massive oaks lying in the road and huge plumes of smoke from various distant fires. But on every side the city is empty. The only sound is of helicopters overhead, dropping water on the fires. The only people are National Guard companies at the intersections, guns at the ready—and, on St Charles Avenue, one lone jogger, running on the streetcar tracks.

Slowly, falteringly and much too late, America began to respond this week to the devastation wrought by Hurricane Katrina. Troops and supplies poured into New Orleans, even as survivors were bused away. The city's Superdome and convention centre, both epicentres of horror in the days after the hurricane, are now empty. The broken levees are being fixed, and water is even being pumped out. By mid-week only 60% of New Orleans, rather than 80%, remained under water. Police were preparing to remove any remaining people by force. The death toll is still unclear, though Ray Nagin, New Orleans's mayor, talks of 10,000 dead.

As relief stumbles along, the political blame-game is in top gear. George Bush and the federal

government have come under fierce attack. Though a CNN/*USA Today*/Gallup poll found that only 13% supposed the president should take most responsibility for the relief effort, or lack of it, both Republicans and Democrats were appalled at Mr Bush's failure to grasp the scale of the catastrophe; shocked that his senior staff were absent, or on holiday, while thousands of Americans were stranded without food and water; and aghast at the bumbling response of the Federal Emergency Management Agency (FEMA), which is charged with coping when disasters strike. America's enemies, from Cuba to Iran, lined up with unconcealed smirks to offer doctors and aid.

Karl Rove, Mr Bush's political Svengali, moved into damage-control mode. Top officials, from Donald Rumsfeld to Condoleezza Rice, were packed off to visit the disaster zone. Mr Bush himself went back again to hug refugees, and said, unpromisingly, that he would launch an investigation. The White House spin-machine whirled into action, trying to shift blame to local and state officials. The federal government, claimed Michael Chertoff, head of the Department of Homeland Security, had only a supporting role to play; it could not, he implied, do much if the locals were incompetent.

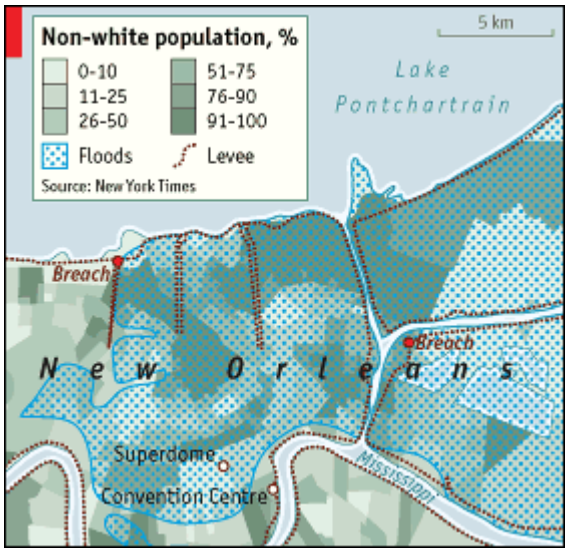
Local and state officials jabbed fingers right back. Kathleen Blanco, the Democratic governor of Louisiana, refused to let the federal government take control of the National Guard relief effort in her state, fearing this would allow the Bush team to blame her for any earlier incompetence. Instead, she hired James Lee Witt, the head of FEMA in the Clinton administration, to advise her on disaster relief.

Pundits explained the government's failure in every way they pleased. Anti-war types blamed Iraq, particularly the fact that thousands of National Guard troops had been sent there. Environmental types blamed Mr Bush's lackadaisical attitude to wetlands. Many Democrats saw it as proof that Mr Bush and the Republicans cared nothing for America's poor and black. Liberals argued that Katrina showed why, as James Galbraith, a vocal leftist economist at the University of Texas, put it, the “government of the United States must be big, demanding, ambitious and expensive.” A *Wall Street Journal* column, in contrast, argued that the hurricane showed the danger of relying too heavily on inefficient government.

The question of racism bobbed quickly to the surface. Jesse Jackson, a one-time presidential hopeful, set the tone. Inspecting the crowded pavement outside the convention centre in New Orleans, he said: “This looks like the hull of a slave ship.”

Absurd though the comparison may be, America's racial rift has been re-opened. Almost all the desperate-looking victims on the television news are black. That partly reflects demography—New Orleans is two-thirds black. It also reflects poverty. Those who failed to leave town typically did so because they had no means of transport. Some 35% of black households lacked a car, compared with 15% of white ones.

Nonetheless, media coverage of Katrina drew furious allegations of subtle bias. Using the term “refugees” for those seeking refuge from the storm was racist, apparently, and Yahoo! News drew flak for picture captions describing a black man as “looting” and whites as “finding” goods. The agencies that supplied the pictures retorted that the captions reflected what their photographers had witnessed.



Many blacks feel that, had it been whites drowning, the federal government would have acted more swiftly to save them. An ABC poll found them 23 percentage points more likely than whites to find fault with Mr Bush's response. “George Bush doesn't care about black people,” suggested Kanye West, a rapper, during a televised appeal to raise money for the victims. His contention is hard to prove. Was the president indifferent, or merely incompetent? Some of Mr Bush's supporters favour a third explanation: that Mayor Nagin (who is black) proved more adept at berating the federal government on the radio than at implementing the city's pre-prepared emergency plan.

To Texas, and points north

Amid all this name-calling, there were a few odd winners. Wal-Mart, for instance, a company that is often under fire from the left for the way it treats employees, was widely praised for the efficiency and unusual generosity of its response. The firm donated $23m to the relief effort; promised jobs in other Wal-Marts for all employees dislocated by Katrina; and proved far more adept than the Feds at getting supplies quickly to where they are needed. The state of Florida, too, which is used to these things, immediately launched an impressive pre-planned relief effort that saw more than $40m in aid, together with teams of doctors and nurses, despatched to neighbouring states.

Around 1m people have been displaced by Katrina. Texas has been the destination of close to a quarter of them. Many have gone to Houston, already the fourth-biggest city in America, to camp in the Astrodome. Other Texas cities have also pitched in: San Antonio has offered temporary housing for 25,000 (as well as practice fields for New Orleans's displaced football team). In Dallas and Austin, convention centres have become shelters.

Governor Rick Perry has been widely praised for his quick response. He has promised extra teachers for displaced schoolchildren and, with Texas's shelters now crammed, he is co-ordinating with other states to take survivors. But the real test lies ahead. As time wears on, keeping a few hundred thousand survivors fed and clothed, not to mention pacified, is a huge challenge—especially since nobody knows when, or whether, they will go home. Texas has already had trouble; people have been turned away from the Astrodome with nowhere to go, and those who are there must endure an 11pm curfew.

Race is inevitably a factor. Most of the New Orleanians seeking public shelter are poor and black.

Barbara Bush, the president's mother, earned no thanks from him for her remark that because many survivors “were underprivileged anyway”, their Astrodome quarters are “working very well for them”. Some white Texans (including many in the Republican base) will “feel that we've got enough minorities in Texas already,” says Richard Murray, director of the Centre for Public Policy at the University of Houston. He predicts that the early euphoria associated with aiding survivors will probably fade, and that crime will increase tensions.

Such sentiments are likely to be echoed in other states also accepting refugees. Arkansas, for example, has opened its doors to more than 70,000 of them, turning National Guard armouries into “readiness centres” and mobilising churches to take refugees into their halls. But Arkansas is itself a poor state, with little cash to spare.

States at the other end of the Mississippi river are also preparing for an influx of Katrina victims. Minnesota has agreed to accept between 3,000 and 5,000, and will temporarily house them at a National Guard encampment in the north-west of the state. Officials say they have lined up longer-term housing for 2,000 evacuees. Wisconsin has space for 1,150 Katrina victims, and will put them up at the state fair grounds and in Milwaukee.

Ordinary citizens have also rented buses or driven down in their own cars to pick up Katrina victims. But not many refugees are willing to travel so far north. When one coach was sent down to Houston, most passengers preferred to be dropped off in Dallas. Hundreds of sympathetic families in Wisconsin and Minnesota have offered to take Katrina victims into their homes, but, as yet, few have had their offers accepted.

AP

A victim of incompetence

That may be as well. Both sides are aware of the tensions that might accrue once short-term needs are met. The refugees will overwhelmingly be black, their hosts white; evacuees will come from a place that ranks last in most every measure of civic health and social cohesion, and will end up in states that rank near the top in all of those measures. No wonder the survivors would rather stay closer to home.

Who pays?

Any help offered also has a price. Jim Doyle, Wisconsin's governor, is hoping that Mr Bush will extend the state of emergency from southern states to northern ones, so that they too can receive federal aid for taking in thousands of people. That may be too much to hope for.

Congress has already agreed to provide $10.5 billion. Since FEMA is currently spending $500m a day on relief and recovery, that will not last long. The White House has already asked Congress for an additional $52 billion. Together, Florida's four hurricanes in 2004 cost the federal government $14 billion, while insurers paid out much more. This time, the ratio will be reversed.

The insurance industry is in shock. Loss-adjusters still cannot get close enough to assess much of the damage; hundreds of them have fanned out across the region, trying to work their way in from the edge to the centre of the catastrophe. Latest estimates suggest that the damage to homes, businesses and infrastructure is around $100 billion, with private insurance claims as high as $35 billion. Some property owners without flood insurance (which mortgage lenders require of most people living in flood-plains) will get relief from a federal disaster-loan programme. Only

about half of property owners in New Orleans hold flood coverage, and even fewer in hard-hit patches of Mississippi and Alabama. Renters and those who own homes outright are most likely to be uncovered.

America's insurers have had some bruises of late: 2004 was the worst year for catastrophes on record, and this year will surpass that. Stricter underwriting means that the industry as a whole is in better shape than it was in 2001, but Katrina will hit profits. Reinsurers, the big firms that provide a safety net in major disasters, will take the brunt of the burden. For now, the majors contend they can handle the fallout from Katrina, but losses—including those for interrupted business—are mounting by the day.

The broader economic fall-out of Katrina remains uncertain. Traditionally, big hurricanes—for all their devastation—have had only a small effect on the macroeconomy. Katrina, though, may well be a different case.

Forecasters have cut their expectations for GDP for the rest of the year—the Treasury by half a percentage point, the Congressional Budget Office (CBO) by slightly more. But some have raised them for 2006 as reconstruction efforts boost output. The CBO fears that, from now to the end of the year, 400,000 jobs may be lost, though employment is “likely to rebound” later. The big unknown remains fuel costs (see article) and the risk that soaring prices for petrol, let alone physical supply shortages, will hit consumer spending hard.

Financial markets certainly seem gloomier about the country's growth prospects. Before Katrina hit, futures prices suggested the central bank would continue its upward march in interest rates over the next few months. Now, the markets reckon the Federal Reserve will cut this process short. But this week the president of the Chicago Fed sounded a different note, emphasising the risk of higher inflation.

And the fiscal impact could end up being sizeable. Some politicians talked of spending more than $150 billion on recovery and relief. Washington's budget boffins worry that all kinds of other requests will be attached to money for Katrina relief, such as (paradoxically) drought relief for farmers in the mid-west. Moreover, the political aftermath of the hurricane may dampen lawmakers' already tepid enthusiasm for budget-cutting. The 2006 budget—agreed in principle but not in detail—is supposed to include $35 billion in budget cuts over next five years, including in Medicaid, the federal-state health-care programme for the poor. Politicians will be loth to do any such trimming when America's vulnerabilities, in almost every region of social policy, have been so ruthlessly exposed.

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Economist.com SPECIAL

The future of New Orleans

The way of Babylon?

Sep 8th 2005 | NEW ORLEANS
From The Economist print edition

What lies ahead for an irreplaceable city

THE question is awful, but will not go away. How much damage can a big American city suffer without going the way of Babylon? Or, for that matter, of Galveston, a boom town that never recovered from a hurricane in 1900?

The deputy police chief says that New Orleans has “completely been destroyed”. He exaggerates, but not greatly: around 140,000-160,000 houses have been submerged or ruined. The 10,000 or so people who, at mid-week, were still clinging on in their homes were ordered to leave, not least for their health; three people in the region had already died from drinking water seething with viruses and bacteria. If force did not work, money might: at the shelters in Texas and elsewhere, FEMA agents were handing out $2,000 debit cards.

If the city is abandoned, how quickly can it recover? It all depends on how quickly the city's drainage system takes water out, how efficiently the 60m-90m tons of raw sewage are cleaned up, and how soon the power comes back on. And on other, longer-term, calculations.

New Orleans was already losing people before Katrina; its population peaked, at almost 630,000, in 1960. At the last census count, in 2000, 485,000 people lived there. Officials now fear that as many as 250,000 will leave for good, and that dull-but-prosperous Baton Rouge will soon become Louisiana's economic centre. New Orleanians have long disdained their state's capital. But it stands on the first high ground along the Mississippi, and its population of about 230,000 has supposedly doubled in past days. Evacuees are already buying houses in its suburbs.

New Orleans officials are busy discussing how they might lure people back. They intend to set up centres in every area where the refugees have gone, telling them how the clean-up is progressing. They might pay the poor to go back, and offer incentives to the rich. Urgently, they are hunting round for “creative legislation and ideas”.

Until last week, New Orleans's usually sluggish economy was showing signs of life. Developers were turning decrepit commercial buildings into yuppie condominiums, film-makers were flocking in to profit from generous tax credits, and the city's two medical schools were hopeful of attracting researchers. They still might. Though Dennis Hastert, the speaker of the House of Representatives, has said spending federal money to restore New Orleans “doesn't make sense to me”, there could yet be a massive effort to strengthen the city's levees, to restore the coastal marshes that once protected it and to rebuild.

But tourism had been New Orleans's main growth industry. And while the French Quarter is largely intact, the Superdome and the Ernest N. Morial Convention Centre, two key hubs for that industry, have become notorious the world over as monuments to misery.

Worse, the hurricane could well exacerbate the tensions that lurk in the city. Most of the richer white neighbourhoods lie on natural levees created over centuries. On lower ground are the

poorest districts, whose residents are overwhelmingly black and, now, deeply resentful. Some rattled New Orleanians may never again feel safe after watching their city fall into anarchy.

Long before Katrina struck, the New Orleans Police Department was already having trouble keeping crime under control. Then around one-third of its officers disappeared from the force (perhaps quitting, perhaps drowned) in the days after the hurricane. Those that remain are to be sent on morale-raising trips to places that speak volumes about the city's woes. Some officers will get free tickets to Las Vegas, which in recent years has come to dominate the convention business that New Orleans craves. Others will go to Atlanta, the corporate hub that so many ex-New Orleanians now call home.

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Economist.com SPECIAL

Katrina and oil prices

No safety net

Sep 8th 2005 | NEW YORK
From The Economist print edition

Could the hurricane set off an energy crisis?

AP

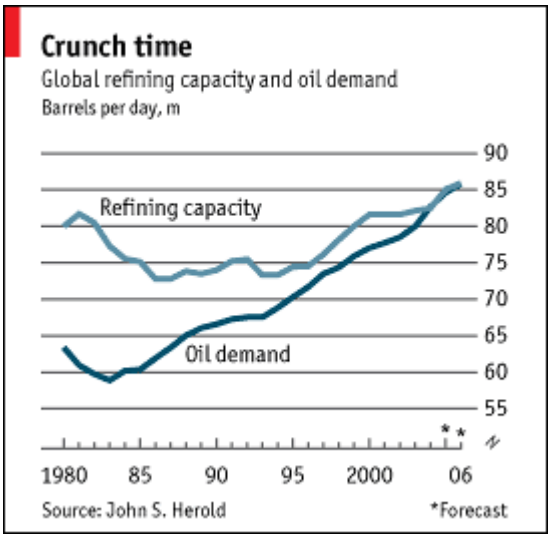
Higher and higher

HURRICANE KATRINA could lead to “one of the biggest energy shocks since the 1970s, perhaps even the biggest.” So argues Daniel Yergin, a historian of oil and head of CERA, an energy consultancy. He is not alone. Various oil veterans, some of whom were fairly relaxed during the demand-fired rise in oil prices from $10 a barrel in 1999 to $70 recently, are now concerned that this storm could push the oil market into a global crisis and perhaps drag the world economy into recession.

At first blush, it is hard to take such gloomy views seriously. America's economy is growing at a healthy clip, as is the world economy. What is more, history shows clearly that natural disasters like hurricanes do not have an enduring impact on the economies of rich countries. The damage done to economic output in the short term is always made up (or more) later on by a reconstruction boom. The behaviour of oil markets also called the gloomy view into question. By midweek, crude oil prices—which had risen at first to a nominal record of $70.85 a barrel—had fallen back sharply, to around $65.

So does that mean the oil sector has been spared Katrina's wrath? Not necessarily. First, Mr Yergin observes that no hurricane has ever destroyed as much of the entire value-chain of energy infrastructure, from offshore rigs to underwater pipelines to refineries and power lines on shore. On current evidence, Katrina's shockwaves will be wider, and last longer, than those of previous storms.

The world crude-oil market will not suffer particularly. Although perhaps half of the output of the Gulf of Mexico, itself accounting for about a quarter of America's oil and gas output, is still shut down, prices have not shot up, because world markets were over-supplied with crude when the storm hit. The crunch is in refining and refined products such as petrol. OECD countries have agreed to release government crude-oil stocks, but America has no strategic stocks of petrol and Europe has too little to make a difference.



The world's refining sector was already stretched to the limit before Katrina hit (see chart). The problem was most acute in America, where demand has far outpaced refining capacity. As a result, America imports about a tenth of its petrol, up from just 4% a decade or so ago. Domestic refining volumes have gone up, but not enough; and Katrina has now knocked out eight refineries, representing perhaps a tenth of the country's capacity.

Half of those refineries might be back on line within weeks—but officials say the others may take a couple of months. This would be “a huge problem, since there is not enough spare refining capacity globally,” says John Paisie of PFC Energy, a consultancy. Traders are already starting to fill the gap with petrol from European and South American markets, raising prices across the world.

Fadel Gheit of Oppenheimer, a fund-management firm, is concerned. Most of the refinery workers, he points out, are still unable to return to their jobs as most lost their homes and many lost family members. He points out that the hurricane season is not over yet, and when it passes another menace will arrive: peak winter demand, which will replace demand for petrol with clamour for heating oil.

The second great unknown is how consumers will respond to short-term price rises and sporadic shortages. Already, prices in some areas have jumped a dollar since the storm, touching $4 a gallon or higher. In other places, brief shortages have been reported. With most commodities, higher prices dampen demand. Yet demand for petrol is pretty inelastic in the short term. Even if prices rise, soccer moms still have to go to work and drop off their children at school. Philip Verleger, an economist affiliated with the Institute for International Economics, a think-tank, suggests that it would take a doubling of petrol prices to reduce American petrol consumption by just 5%. He worries that “rising prices are going to require consumers to double expenditures on gasoline, electricity, and heating fuels. Other spending will be cut—and recession will follow.”

That remains a minority view among economists; but, for the first time since the 1970s oil shocks, there was semi-serious talk in official Washington this week of conservation measures. The full Senate Energy Committee sent a letter to George Bush asking him among other suggestions, to encourage federal government employees to share cars. Senator Pete Domenici, the Republican head of the committee, even floated an idea that Mr Bush hates: raising vehicle fuel-economy standards, which are close to a 20-year low.

The third great unknown about oil is whether the world will see a second blow to the system before Katrina's damage is undone. This question is the more urgent since governments have now

committed themselves to releasing a chunk of their official stocks of petroleum on to the open market. Once those are depleted, the world will be much less able to cope with the all too common surprises (coups, civil strife or terrorist attacks) that lead to supply disruptions in oil-producing countries.

What would happen if there were two moderate blows to the world oil economy at once? America's National Commission on Energy Policy (NCEP), a group of leading energy gurus and politicians from both parties, asked that question recently. In an elaborate exercise, the group “gamed” out the likely impacts of a natural calamity and a supply disruption amounting to just 4% of the world's oil supply. Their conclusion: prices would probably jump from $60 (their assumed baseline) to over $160, even without any massive al-Qaeda attack on vital Saudi oil infrastructure.

At the time of the first Gulf war, such a prognosis could never have been made. Back then, global demand was much lower and the world had plenty of spare production capacity. But today, as the run-up in prices before Katrina had already made clear, there is no safety net.

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Economist.com SPECIAL

The United Nations

Can its credibility be repaired?

Sep 8th 2005
From The Economist print edition

World leaders are setting about reforming a flawed world body at a time when it has been further weakened by the Iraqi oil-for-food scandal

Get article background

ON THE eve of a world summit that is to look both at the reform of the United Nations and at the Millennium Development Goals set five years ago to free mankind from extreme poverty (see article), the beleaguered world organisation is wincing from a crippling body blow. In a devastating report, the independent committee of inquiry into the oil-for-food scandal castigates virtually every aspect of the UN, including its powerful Security Council. Kofi Annan, its secretary-general, is criticised for a disastrous failure of leadership and supervision, though he is cleared of any personal wrong-doing.

The three-man committee, chaired by Paul Volcker, a former head of America's Federal Reserve, paints a grim picture of corruption both inside and outside the UN system, with evidence of bribes, kickbacks, smuggling and other illicit deals going on throughout most of the seven years of the vast $100 billion programme that was set up by the Security Council in 1996 to alleviate the suffering of the Iraqi people after six years of economic sanctions.

Although the programme did achieve important successes—notably in providing Iraqis with minimum standards of nutrition and health—it was dogged from the first by reports of waste, inefficiency and corruption. Some of this, the committee says, was rumour and exaggeration. “But much—too much—has turned out to be true.” The organisation's credibility rests on member-states' perception of its competence, honesty and accountability. But it was precisely those

qualities that were too often absent in its administration of the programme.

The committee's earlier reports focused on the failings of the secretariat. In this, its penultimate and most comprehensive report to date, it turns its attention to the Security Council. The council was responsible both for setting up the programme and, through its sanctions committee, for supervising it. But, says the Volcker committee, differences between member states led to vital decisions being blocked, a blind eye being turned to large-scale oil smuggling, and the aiding and abetting of “grievous” weaknesses in the administrative practices within the secretariat. When things went awry, as they certainly did, nobody was in charge.

Although the committee found only “isolated instances” of corruption within the secretariat—just three officials out of a total staff of 15,000 have been charged so far, including the programme's head, Benon Sevan—it believes that those “egregious lapses” signalled the absence of a sufficiently strong organisational ethic. Most of the corruption that was uncovered took place outside the secretariat, among the private contractors and individuals who did business under the programme. It was also found among members of the nine UN agencies working on the ground in Iraq where the committee says corruption was “endemic”.

Senator Norm Coleman, the Republican chairman of one of the several American congressional committees that have been carrying out inquiries into the scandal, has alleged that Saddam Hussein siphoned off $21 billion before and during the UN programme. The Volcker committee, as a result of its own exhaustive inquiries over the past year, puts the former dictator's illicit income over the seven years of the oil-for-food programme at $10 billion. Of this, less than $2 billion came from the illegal surcharges on oil purchases, kickbacks on the sale of humanitarian goods and the inland transport fees that Mr Hussein demanded from contractors. The rest came from smuggling oil, and sanctions-breaking trade with neighbours that had nothing to do with the UN.

Saddam's favourites

The committee notes that the vast and complex programme presented the UN with unprecedented challenges. The programme, it says, was flawed from the outset. In order to get Saddam Hussein's agreement, the Security Council allowed him to choose with whom he wanted to do business. Early on, Iraq made it clear that it would give preference to companies from countries perceived as sympathetic to the easing of sanctions, including Russia, France and China, all permanent members of the council. These companies duly got the bulk of the contracts.

In addition, Iraq gave oil “vouchers” or allocations to individuals who it believed would be able to help with the lifting of sanctions. The rights to the vouchers could then be sold on to an oil company for a hefty commission. Mr Sevan was among the many beneficiaries, the committee says, along with “present and former politicians and diplomats, members of organisations supportive of Iraq, members of influential families in the Middle East, lobbyists and media figures.” Tantalisingly, the committee provides no names, though it says it will bring out a final report next month giving details of “outright corruption” among contractors.

Reuters

Bolton and Annan: a beautiful friendship?

The urgency for reform

Given the scale of the oil-for-food programme and the involvement of so many arms of the UN, the committee believes that the failings it found are symptomatic of “systemic problems” throughout the organisation. Its inescapable conclusion is that the organisation needs thoroughgoing reform—and urgently.

As the committee itself notes, it is not alone in that view. Several recent studies have come to an identical conclusion, including the High-Level Panel on Threats, Challenges and Change, a body set up by Mr Annan himself. Its report, produced last December, forms the basis of the proposals for reform that over 170 heads of state and government, including George Bush, have been invited to endorse in New York between September 14th and 16th.

That makes it sound simpler than it actually is. There has been enormous trouble in drafting the so-called “outcome document” which, based on the panel's proposals, will be presented to the summit. The bargaining has been mired in furious wrangling between member states, with the United States pitched against a group of developing countries, including Cuba, Pakistan and Egypt.

On his arrival in New York last month, John Bolton, America's assertive new ambassador to the UN, threw the negotiations into further crisis by insisting on hundreds of last-minute changes to the 39-page draft document that everyone else had thought was pretty near complete. Although many of the alterations demanded were purely stylistic or anodyne, some tore into the delicately balanced “grand bargain” between rich and poor countries that the UN had taken such pains to erect.

Under that bargain, the poor countries were to have the Millennium Development Goals reaffirmed, along with promises of more aid and debt relief, a pledge to tackle climate change and progress on disarmament. The developed world, for its part, was to get a clear definition of terrorism that included those considered “freedom-fighters” by some, an agreed right to humanitarian intervention, a powerful new human-rights body that would exclude human-rights violators, the creation of a new “peacebuilding commission” to help the reconstruction of post-war states and UN management reform. Though far from delighted, the developing countries appeared ready to accept most of this.

Their compliance changed with Mr Bolton's entry on the scene. Although the panel's proposals, largely endorsed by Mr Annan in his own report to the General Assembly in March, had been

partially watered down during earlier negotiations, their essence had been preserved. But Mr Bolton's line-by-line amendments, including his widely reported insistence on the deletion of all specific references to “Millennium Development Goals”, the International Criminal Court and the Kyoto summit, along with what were perceived as his bullying tactics, opened a Pandora's box. The developing countries retaliated with a string of their own amendments which, if adopted, would have emasculated the whole document.

The situation appeared dire. How could the biggest gathering ever of world leaders be presented with what threatened to turn into a bunch of meaningless platitudes? Jean Ping, the Gabonese president of the General Assembly who is responsible for supervising the preparation of the outcome document, rushed to mount a rescue operation. A “core” group of some 30 countries, including the five permanent members of the Security Council, was set up with a brief to negotiate day and night, including weekends, to thrash out a compromise. A deadline of Saturday, September 10th, was set, supposedly allowing just enough time for the necessary translations to be prepared before the summit begins next Wednesday. But with some 250 bracketed pieces of text still being fought over, it seemed doubtful whether this deadline could be met.

Then, at the last minute, things began to ease a little. The Americans partly changed tack, offering to re-insert references to the Millennium Development Goals (provided they were appropriately defined), the overseas aid target of 0.7% of GDP (while making it clear that they did not accept it for themselves) and the Kyoto Protocol on climate change (stressing that the United States was in no way committed to it). It has yet to be seen whether these largely symbolic concessions will result in enough compromises from the developing world to produce an acceptably substantive text.

Listed below are the main issues that have to be resolved if the UN is to have a chance of repairing its credibility, together with the latest state of play at mid-week.

•Use of force and collective security

Agreement on this is crucial. It must be reached, says Mr Annan, “if the UN is to be a forum for resolving differences rather than a mere stage for acting them out.” But the dispute over force still rages.

Under the UN Charter, the use of force is permitted only in self-defence or when authorised by the Security Council. The Americans, after failing to get council approval for their strike against Iraq in 2003, argued that the right of self-defence should be extended to include preventive strikes against latent or non-imminent threats.

The high-level panel agreed that there were situations where force should be used to prevent a threat becoming imminent. But it argued that such decisions should be made collectively by the Security Council on the basis of five criteria: the seriousness of the threat; if the primary purpose was to avert the threat; if every non-military option had been explored; if the scale of the proposed military action was the minimum required; and if there was a reasonable chance of the action being successful.

These criteria are now being attacked from all sides. The Americans believe that some of them are too restrictive; some developing countries are trying to insert a clause rejecting “unilateralism”.

•Humanitarian intervention

The Charter prohibits intervention “in matters which are essentially within the jurisdiction of any state”. But the panel argued that the principle of non-intervention could no longer be used to shield genocidal acts and other atrocities. The UN should assume a “responsibility to protect”

civilian populations when governments were “unable or unwilling” to do so. Military action should be authorised by the Security Council as a last resort.

All this was warmly endorsed by Mr Annan in his report. But the United States, anxious not to be tied down by anything smacking of a legal commitment, is seeking to dilute the language. It had already succeeded in expunging the word “obligation” from the draft text. Now it wants to do the same with the suggestion that the international community has a “shared responsibility” to take collective military action when peaceful means have failed; it prefers the weaker formulation “we are prepared to take” action.

•The Security Council

The council's membership has become increasingly anachronistic and unrepresentative. But apart from the addition of four non-permanent members in 1963, bringing total membership to 15, it has eluded all reform. This is partly because of the rivalries of nations competing for seats and partly because of the blocking power of the five permanent veto-wielding members: America, Russia, China, France and Britain, known as the P5.

The panel put forward two options for reform, both involving an expansion from the current 15 members to 24. Under Model A, there were to be six new permanent seats without veto powers: two each for Africa and Asia and one each for Europe and the Americas, plus three new two-year non-permanent seats. Model B provided for no new permanent seats. Instead, it proposed the creation of a new category of eight four-year renewable “semi-permanent” seats along with one new non-permanent non-renewable seat.

Model B was quickly consigned to the rubbish bin by states who hoped to win a permanent seat. India, Brazil, Japan and Germany formed an alliance, dubbed the G4, to press jointly for permanent seats. But their hopes dimmed at the end of July when they failed to get the backing of the 53-member African Union, vital for winning the two-thirds majority vote in the General Assembly required for a Charter amendment.

All plans for Security Council reform are now in tatters and may remain so. The draft document, while agreeing that the council should be made more representative, fails to say how. The Americans, who would have to ratify any change, have said they might be willing to consider “two or so” new permanent members, including Japan, along with “two or three” new non-permanent ones, but have won little support for their ideas. So it is back to the drawing board.

•Terrorism

Attempts to find an acceptable definition of terrorism have hitherto foundered on the insistence by Islamic countries that it exclude the “armed struggle for liberation and self-determination”. But the high-level panel, which included Amre Moussa, the secretary-general of the Arab League, managed to agree unanimously that “any action intended to cause death or serious bodily harm to civilians or non-combatants, when the purpose of such an act, by its nature or context, is to intimidate a population or to compel a government or an international organisation to carry out or to abstain from any act, cannot be justified on any grounds and constitutes an act of terrorism.” Claiming you were acting as a “freedom fighter” would no longer be an adequate excuse.

This hard-won definition succeeded in making its way more or less intact into the latest draft document. But some developing countries are still insisting on the insertion of a clause drawing a distinction between terrorism and “the legitimate right of peoples under occupation to struggle for their independence and in defence of their right to self-determination.”

•Peacebuilding Commission

The high-level panel proposed a “Peacebuilding Commission” to help prevent post-conflict nations from relapsing into violence. But a row has broken out over its control. The Americans and Europeans want it to be set up under the auspices of the Security Council with the P5 assigned automatic membership on the new body. Developing countries, who think the council, especially the P5, already have too much power, want it to come under the General Assembly where they account for a majority of the members.

•Human Rights Council

The panel's recommendation that the UN's discredited 53-member Commission on Human Rights be replaced by a smaller, more powerful Human Rights Council has received widespread support. But it is being fiercely opposed by those who have most to fear. As Mr Annan has pointed out, “states have sought membership of the commission not to strengthen human rights but to protect themselves against criticism or to criticise others.” Zimbabwe, China and Cuba are all current members.

Although the principle of a new body could survive, its set-up may not be very different from the existing one if the opponents of change get their way. The Americans want the new council's membership to be limited to 30 and to exclude any state subject to UN sanctions or investigations into human-rights violations. But the developing nations want the council to be as big (and unwieldy) as the current commission, with no one automatically excluded.

•Non-proliferation

This is the part that has generated some of the fiercest disputes of all. The Americans want greater emphasis on arms control. They believe the proliferation of weapons of mass destruction constitutes “the pre-eminent threat to peace and security”. The developing world wants the West to do much more about disarmament. Almost every word of the section is still being wrangled over.

Is Annan to go or to stay?

Mr Coleman, who was the first to demand Mr Annan's scalp last December, is now demanding it again. He says the secretary-general should take responsibility for the fraud, administrative bungling and leadership failures identified in the Volcker report. If Mr Bolton, a fellow-conservative, agreed with the senator, he did not say so. Instead, he suggested that the committee's findings be used as a “catalyst for change”. Could a new, more accommodating, UN-friendly Mr Bolton be emerging? Although he caused deep irritation with his last-minute amendments, many of them helped improve the document's text.

For Mr Annan, 2003 was a year of “deep division” over the Iraqi war. The next year was “a time of sober reflection”. But 2005 “must be a year of bold action”. Next week's world summit, he says, will provide a once-in-a-generation opportunity to achieve real change, “and if we fail, I don't know when the opportunity will come again.” The survival of the United Nations is not at stake; the organisation will probably continue to chug along whatever happens. But its credibility is at stake, and without credibility, this flawed but indispensable body will not be able to do much good in the world.

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The Supreme Court

The battle begins

Sep 8th 2005 | WASHINGTON, DC
From The Economist print edition

John Roberts's nomination as chief justice makes the coming Senate hearings all the more momentous

Get article background

IT WAS always going to be an intense week for John Roberts. But it suddenly grew more so. On September 6th, he was due to be grilled by the Senate to see if he would make an adequate Supreme Court justice, having been nominated two months ago to replace Sandra Day O'Connor, who is retiring. But on September 3rd, Chief Justice William Rehnquist died of thyroid cancer (see article). Two days later, President George Bush nominated Mr Roberts to succeed him as the nation's top judge.

Mr Roberts's confirmation hearings were postponed until September 12th, out of respect for the late chief justice, and perhaps to allow Mr Roberts time to mourn the man he once clerked for. Senate Democrats, meanwhile, are preparing tougher questions for Mr Roberts. His nomination as chief justice “raises the stakes”, said Charles Schumer, a Democrat on the Senate judiciary committee. “Exponentially,” added Ralph Neas of People for the American Way, a liberal lobby group.

Mr Roberts is only 50. Supreme Court judges have jobs for life (though Mr Roberts once argued that they should not, lest they “lose all touch with reality”). If confirmed, he could set the court's tone for a generation. Since the court is the arbiter of whether laws are constitutional or not, Mr Roberts's appointment would continue to shape America long after Hurricane Katrina has faded

into the news archive. And there is still another Supreme Court vacancy for Mr Bush to fill.

Republicans and Democrats alike noted Mr Bush's shrewdness in promoting Mr Roberts so fast. As the president put it: “For the past two months, members of the United States Senate and the American people have learned about the career and character of Judge Roberts. They like what they see.” Journalists have delved deep into his closets without finding anything resembling a skeleton. Liberals find him personally likeable.

Mr Bush could have tapped a more seasoned right-wing judge, such as Antonin Scalia or Clarence Thomas, who between them have already sat on the top court for 33 years. But the radical Justice Thomas might have proved harder to push through the Senate, while the 69-year-old Justice Scalia will probably not, to put it bluntly, live as long as Mr Roberts.

Set beside some of his predecessors, Mr Roberts may seem inexperienced. William Rehnquist had been a Supreme Court judge for 14 years before he was elevated to the top job. Earl Warren had been governor of California. William Howard Taft had been president of the United States. Mr Roberts has been an appeals-court judge for only two years.

Nonetheless, few people believe he will be out of his depth. Even his foes concede that he has a brilliant legal mind. He served in two White Houses (under Ronald Reagan and the first President George Bush). And as an advocate, he argued no fewer than 39 cases before the Supreme Court.

Opposition to Mr Roberts's nomination has focused on his views, inasmuch as they can be discerned from mountains of old memos he wrote while a government lawyer and a short list of rulings as a judge. His supporters describe him as conservative, but cautiously so; a man who, in his own words, believes that the court should not “view itself as ultimately responsible for governing all aspects of our society”. Leftists see it differently. The Alliance for Justice, a lobby group, says he “lacks sufficient appreciation for how the law affects ordinary people” and “would move the court away from preserving the rights, freedoms and legal protections that Americans cherish.”

Much of the mud slung at him seems to have missed. NARAL Pro-Choice America, a lobby group, put out a televised commercial suggesting that he sympathised with abortion-clinic bombers. This was a monumental distortion. He once filed a brief arguing that, while blockading abortion clinics was illegal under state law, it did not violate a federal statute aimed at suppressing the Ku Klux Klan. A convicted clinic-bomber was one of many anti-abortion activists involved in the case, but the case was not about bombing. NARAL withdrew the ad and replaced it with a fairer one.

Mr Roberts's actual position on abortion is ambiguous. He has called it a “tragedy”. He has referred to the right of privacy that underpins *Roe v Wade*, the Supreme Court ruling that made abortion legal throughout the country, as the “so-called right of privacy”. On the other hand, he has also called *Roe* “settled law”. That suggests he might chip away at it. But would he vote to overturn it? The only certainty is that he will dodge questions about it during his confirmation hearings.

Some of Mr Roberts's detractors say he opposes equal rights for women. Kim Gandy, the president of the National Organisation for Women, described his attitude towards them as “Neanderthal”. A cartoon in the *Atlanta Journal-Constitution* repeated an accusation that he “opposed equal pay for women” and showed him asking Ruth Bader Ginsburg, the other female justice, to fetch him a coffee.

The evidence for these charges is slight. Mr Roberts didn't oppose equal pay for equal work. He opposed equal pay for different work. Or, as it was known in the 1980s, the theory of “comparable worth”, which held that if wages for a female-dominated profession (such as librarian) are lower

than those for a male-dominated one that a bureaucrat deems of equal value to society (such as plumbing), the government should equalise them. Mr Roberts argued that this would require “central planning of the economy”.

Black groups largely oppose Mr Roberts, because he apparently believes that the law should be colour-blind. Such a view would threaten affirmative action, an institution prized by leftists, and treated inconsistently by a court that is as divided as public opinion is on the subject. In 2003, for example, the court upheld a university's racial preferences in admissions while guessing that they would not be needed in 25 years. Go figure.

On gay rights, Mr Roberts's opponents cannot plausibly argue that he is a bigot. Indeed, the fact that he once did pro bono work for gay-rights groups appals many of his social-conservative backers. But some liberals fret that his scepticism about the “right to privacy” might make him reluctant to strike down state anti-sodomy laws. And he is unlikely to discover a constitutional right to gay marriage, as many activists wish judges would. But there is another way to legalise gay marriage. State legislatures can pass laws allowing it, as California's did this week. Governor Arnold Schwarzenegger will veto the bill, but that is democracy.

For civil libertarians, one of the biggest worries about Mr Roberts is his laisser-faire attitude to the secretive military tribunals Mr Bush has used to try terror suspects. As an appeals-court judge, he ruled in July that these were legal. As it happens, the Pentagon announced plans last week to fix some of the tribunals' more egregious flaws. But still, many feel that Mr Roberts has shown an alarming deference to the executive branch.

The chief justice, like his eight associates, has only one vote. His extra powers are soft ones: he chairs the court's internal debates and, when voting with the majority, decides who should write the court's opinion. The job is like herding “hogs on ice”, reckoned Mr Rehnquist. Is Mr Roberts up to it? His light touch might help. “Only Supreme Court justices and schoolchildren...take the entire summer off,” he once wrote, adding that “The Constitution is safe for the summer.”

With Republicans holding 55 of the 100 Senate seats and some Democrats leaning towards supporting him, Mr Roberts will probably be confirmed in time for the court's next session in October. Senate Democrats may give him a rough ride simply to show that they are not a pushover, in the hope that Mr Bush will shrink from naming a firebrand to sit in the court's other vacant seat. But this is probably the issue Mr Bush's base cares about most—they think liberal judges are illicitly rewriting laws to undermine family, religion and the sanctity of life. So Mr Bush won't want to disappoint them. Don't be surprised if he names someone charming but solidly conservative. He's done it before.

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America's other disaster

Resurrection delayed

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Ground is broken at Ground Zero

IN STARK contrast to New Orleans, New York takes justified pride in its response to its own disaster on September 11th 2001. There was confusion, but also planning and discipline. No wonder there were calls this week for President George Bush to put Rudolph Giuliani, who was mayor of New York on that day and master of that crisis, in charge of the New Orleans relief effort.

But when it comes to reconstruction, the record in New York has been less impressive. Mr Giuliani's term was up soon after 9/11, leaving nobody much to bang heads together. Only in June this year did the key parties to the World Trade Centre site—the Port Authority of New York and New Jersey, which owns the land; a property developer called Larry Silverstein, who leases it; and the New York Police Department, which has to keep it safe—agree on a redesign of the main new skyscraper, the Freedom Tower, making it even more bomb-proof and even less beautiful than the first draft. That should be up by 2010 and more towers by 2015. On September 6th ground was broken for a huge new public-transport interchange which will link the World Trade Centre site to 11 subway lines, a ferry terminal and a commuter railway line serving New Jersey.

Plans for a subterranean museum and a cultural centre at the site are also approaching final form, amid much acrimony: groups representing 9/11 victims' families have assailed the museum as too small and the cultural centre as an unwelcome and unpatriotic distraction. The museum will probably house remnants from the site, including fire-trucks, fragments of the façade and melted furniture, which are currently stored in a hangar at Kennedy Airport. At ground level will be two pools occupying the “footprints” where the towers of the World Trade Centre once stood.

But even with the Freedom Tower soon to rise, it is unclear whether downtown New York will ever recover its role as the city's financial hub. Last month Goldman Sachs, attracted by generous tax breaks, agreed to build a new headquarters next to the World Trade Centre site. But other investment banks have migrated uptown and seem happy enough. Downtown has been evolving into a district of small businesses, homes and parks. Relative calm has returned. New Orleans should be so lucky.

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Farm labour

The grapes of wrath, again

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From The Economist print edition

The miserable state of California's farm workers

THE heat is relentless, with the summer sun baking California's San Joaquin Valley to 100 degrees Fahrenheit (38 Celsius) and more. In the Giumarra family's vast vineyards, Latino workers, most of them illegal immigrants from Mexico, toil against the clock to pick and pack table grapes for the princely sum of $7 an hour and 30 cents for each box. On July 22nd, one such worker, Agustin Gudino, was found dead among the Giumarra vines, the morning after a ten-hour shift picking grapes. A second worker collapsed in a tomato-field, a third while picking bell-peppers, a fourth while picking melons.

In theory, such deaths on California's farms should never happen again. On August 22nd new rules came into effect requiring employers to provide shade for at least five minutes of “recovery time” for any worker feeling the heat, and to provide a quart of water for every worker for each hour worked. The regulations, said Governor Arnold Schwarzenegger, “should have been done many, many years ago.”

But they were not. California's previous Republican governors, George Deukmejian and Pete Wilson, rolled back the enforcement of labour laws that had looked tough on paper. When Democrats in the state Assembly voted for a bill in July requiring the kind of measures just ordered by Mr Schwarzenegger, every Republican voted against it. Some four decades after Cesar Chavez and the United Farm Workers of America (UFW) fought to improve conditions for California's farm workers, they remain a disgrace.

Aguileo Rangel lives in a tiny room at a Giumarra labour camp—provided by the company for $70 a week, meals included—with his wife, a teenage son (currently recovering from meningitis) and two daughters, aged ten and three. The workday for Mr Rangel, together with his wife and son, begins at 6.30am, and involves kneeling down for the next eight hours to pack grapes. The two little girls are left back at the labour camp to fend for themselves. Recreation at the end of the day consists of listening to Mexican pop music and drinking beer for a dollar a can.

Why does it happen? The first part of the answer is easy: until life improves in the Mexican countryside, there will always be migrants ready to undertake a perilous journey north. Some will work in America's hotels and restaurants, others on its construction sites—and the least qualified will end up as pickers, many of them following the harvest as it moves from state to state. According to the Department of Labour, some 53% of America's farm workers are “undocumented” foreigners; in California, most estimates would go as high as 90%.

But another part of the answer is the structure of California's agriculture. Statistically, it amounts to big business: the Golden State, with the largest agricultural sector in the nation, produces more than 250 commodities, from almonds to walnuts, and leads the nation in 75 of them (almost all of America's grapes and dates, and more than three-quarters of its strawberries and lettuce, come from California). Yet large companies such as Giumarra, one of the world's biggest agricultural seed companies, are relatively few. The average size of the state's 88,000 farms is a mere 315

acres, compared with a national average of 436. Factor in the vagaries of insects and weather (a rainstorm can ruin a strawberry field), and life for the typical farmer is tough. As Paul Betancourt, a cotton and almond farmer in Kerman, puts it: “The number one driving force for most farmers is survival.”

Hence the desire to cut labour costs. Farmers rarely hire their migrant workers directly; instead, they use labour contractors who will supply workers as and when they are needed. That makes practical sense: since harvests vary according to the crop and last for only a few days, few jobs can be long-term. It also makes good legal sense. Employers are meant to verify the immigration status of their workers, so making the contractor go through the fiction of checking for fake Social Security numbers gets the farmer off the hook.

The problem is that there are few safeguards against unscrupulous contractors who cheat their workers, for example by denying them their legal break-times or by underpaying them. And what compounds the problem is the understandable reluctance of undocumented workers—the polite term for illegal immigrants—to complain, even though federal agencies exist to protect all workers, legal or not. The AFL-CIO recalls that in July in North Carolina the Immigration and Customs Enforcement Agency arranged a phoney “mandatory” meeting of the Occupational Safety and Health Administration—and, to the dismay of the genuine OSHA, promptly arrested the illegal immigrants who dutifully turned up.

The unions' solution is to recruit workers and negotiate—if necessary by boycotts and strikes—better pay and conditions. That is more easily scrawled on a banner than achieved in practice. The UFW, which in the mid-1970s under Cesar Chavez had 80,000 members, now claims only around 27,000, and some observers say the real figure is as low as 8,000. Last week, despite a fierce campaign, the union appeared narrowly to have failed to convince Giumarra's workers to sign up (171 ballots are disputed). With two other unions, the International Teamsters and the Food Workers, representing around 7,000 California farm workers, the probability is that only two in every 100 of the labourers toiling in the California fields are represented by a union—even though farm workers in California have had the freedom to form unions since 1975.

But if the unions were strong, would their solution be effective? In some parts of agriculture, probably yes. The modern-minded Mr Betancourt advocates mechanisation, but he then admits that table grapes, tree fruit and strawberries—crops that bruise easily—will always have to be picked by hand.

The real solution, of course, would be a comprehensive immigration reform that recognises that the flow of migrants will never stop while a worker can earn more in an hour in the Giumarra fields than in a whole day in Mexico. Senators Edward Kennedy of Massachusetts, a Democrat, and Larry Craig of Idaho, a Republican, have been pushing an “AgJobs” bill that would give temporary legal status to undocumented migrants who have spent at least 100 days working in the fields since July 2003, and would open a path to permanent residence if they work another 360 days over the next six years. Agricultural organisations support it, but it has yet to pass a Senate (let alone a House) afraid of appearing “soft” on border security. Meanwhile, the sad reality of the San Joaquin Valley is that not too much has changed since John Steinbeck published “The Grapes of Wrath” in 1939. For migrant Okies, just substitute migrant Mexicans.

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Canada's booming west

The good times roll

Sep 8th 2005 | VANCOUVER
From The Economist print edition

The western provinces celebrate, but will Ottawa spoil the fun?

Get article background

BETTER known in Canada as a region of discontent, the western provinces of Alberta and Saskatchewan are currently basking in extraordinarily happy times. Both have been staging extravagant festivities to mark the centenary of their foundation on September 1st 1905. Better still, both provinces, together with neighbouring British Columbia, are booming, thanks to soaring prices for oil and other commodities. Old grumbles of being ignored or short-changed by Ottawa are heard less often now. Even dour Saskatchewanites are managing to crack a smile.

Signs of the good times are unmissable. Long stretches of highway are being resurfaced and widened. In city centres, smart new apartments, malls and office blocks are rising, while on their outskirts new factories are sprouting. “Help wanted” signs are everywhere.

The western provinces' good fortune means that they have replaced Ontario as the engine of Canada's growth. The Conference Board, a think-tank, reckons Alberta will this year enjoy “stellar” growth of 4.2%, as it did in 2004. Saskatchewan, whose economy grew 3.5% last year, can expect 2.7% this year, rather more than Ontario's 2.3%. British Columbia, on top of its windfalls from high oil and coal prices, is doing well from its timber exports, despite a row with their main buyer, the United States (see article). It should grow by 3%, after last year's 4.2% spurt.

When Alberta and Saskatchewan were carved out of the vast Northwest Territories a century ago, they had similar economies, based on farming and ranching. But after the 1930s' Depression,

when agricultural prices collapsed, bankrupting many farmers, the two provinces took different roads. Whereas Alberta concluded that capitalism simply needed to be reformed, Saskatchewan sought to replace it with socialism, creating big welfare programmes, co-operatives and state firms.

Nowadays, Alberta's economy and population far outstrip Saskatchewan's. Peter Lougheed, a former premier of Alberta, insists this is down to his province's “abundance of entrepreneurial drive.” Sceptics (eg, Saskatchewanites) put it all down to the luck of having more oil.

Alberta's fiscal discipline also seems to be paying dividends. In less bountiful times, a decade ago, it shrank its government, cutting provincial spending by 20% and slashing personal and corporate tax rates, which are now the country's lowest. This attracted droves of investors: the province's most populous city, Calgary, now has the second-biggest cluster of company headquarters after Toronto.

Strong investment and surging commodity prices have boosted tax revenues, allowing Alberta's government to pile up huge surpluses, despite the low rates. Last year it ended up with C$5 billion ($3.9 billion) in hand and, earlier this year, it repaid the last of its debt, becoming Canada's only borrowing-free province.

Four years ago, Alberta's success prompted British Columbia's Liberal government to follow a similar script of tax cuts and privatisations, which it claims laid the ground for the province's current boom. Now Saskatchewan's leftish New Democratic Party (NDP) administration is under pressure to follow suit. Businesses there want cuts in taxes on capital investment and property, and sales of public-sector enterprises.

The NDP had earlier cut personal and corporate income taxes, and has recently launched a tax review. But it shows no inclination to get the government out of such businesses as telecoms. Just two years ago, when a provincial election was fought over privatisation, the NDP narrowly won. Roy Romanow, a former NDP premier, says the province's involvement in business has overall been “very, very successful”. Most Saskatchewanites “don't want to be part of the Alberta philosophy that to the strongest and fittest go everything.” But with the NDP retaining power by just one seat, that debate seems far from over.

Albertans, meanwhile, are debating a different problem: how to manage life as the Kuwait of North America. As well as conventional oilfields, their province has huge oil-bearing sands whose exploitation has been made economic by the sharp rise in energy prices. Adding the oil sands' known, recoverable reserves to the others puts Alberta's total reserves second in the world behind only Saudi Arabia's. Around C$80 billion of projects to exploit them are under way or planned.

Such is Alberta's embarrassment of riches that it is running out of things to spend money on. Budgets for schools, hospitals and roads have been increased. Albertans seem content with tax rates as they are, and are not clamouring for further cuts. The province's “rainy day” contingency fund is stuffed with C$12 billion.

What Albertans dread most is the possibility that the federal government might make a grab for their surplus cash. It did so once before, in 1980, imposing a set of taxes and price controls that cushioned Canadians from high world oil prices while stripping Alberta of an estimated C$60 billion gain. Increasingly, Canadians in other provinces, all now suffering the pain of high energy prices, are calling for Alberta's bonanza to be shared.

Mike Percy, the dean of business at the University of Alberta, believes Albertans have nothing to fear: “No federal government would make the same mistake twice because the consequences would be disastrous to Canada as a whole.” Yet a federal election is coming, and prices at the

pump are sure to be an issue. So, too, could be Alberta's treasure chest.

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Economist.com WORLD LATIN AMERICA

Mexico's president

A mixed record

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At least I'm no dictator, says Mr Fox

Get article background

ANYONE who complains of the lack of civility in public discourse in the United States or Europe should visit the lower house of Mexico's Congress. There, each September 1st, the president gives his state-of-the-union address to a rowdy reception. This year, Vicente Fox gave his last such performance before next year's elections (in which he is not allowed to stand), and was interrupted by jeers and catcalls, and mocked by deputies in satirical costumes.

Mr Fox took office in 2000 amid high hopes. He was Mexico's first president from outside the Institutional Revolutionary Party (PRI) in decades. His slogan of *cambio* (change) resonated with a public sick of the PRI's venality. But in many respects change has remained just a slogan. Promised reforms of everything from education to energy have failed to materialise.

The president blames it all on Congress. He argues, lamely, that his failure to impose his will on congressmen at least shows he is a democrat, not a dictator. In truth he and his conservative National Action Party (PAN), which lacks a congressional majority, have proved bad at forming a consensus with either the PRI or the leftish Party of the Democratic Revolution (PRD). Even when the parties have agreed that reforms were needed, progress has been blocked out of sheer pique. The PRI blocked a PAN energy proposal in 1999, so when the PRI proposed an almost identical plan in 2001, the PAN blocked it. This childishness was repeated on September 3rd, when Mr Fox vetoed a similar energy bill, which had passed Congress in June.

Despite such failings, Mr Fox seems to have regained popularity since abandoning his ill-advised attempt, earlier this year, to block the presidential candidacy of the PRD's Andrés Manuel López Obrador—which only boosted Mr López Obrador's chances. A poll last month by Consulta Mitofsky put Mr Fox's approval rating at nearly 60%, though only 15% of respondents approved of his handling of Congress. He has had some successes, most notably in improving openness in government and in developing Oportunidades, a welfare programme that now covers nearly a quarter of the population.

Perhaps the main reason for his improved popularity is that the economy, formerly sluggish, is now ticking along nicely, with high oil prices boosting the revenues of Pemex, the state oil company, which provides around one-third of federal revenues. A more prudent president might have used this windfall to improve Mexico's infrastructure and lay the foundations for future growth. Instead, most has gone on increased current spending, though in the 2006 budget that Mr Fox unveiled on September 6th, spending will be trimmed by around 6% in real terms.

Traditionally, the last years of Mexican presidents' terms have seen economic crises, brought on by pre-election spending binges. Mr Fox seems serious about avoiding such an occurrence on his watch. So, in both good ways and bad, he seems set to be remembered as much for what he has not done, as for what he has.

Canada and the United States

Hard talk on softwood

Sep 8th 2005 | VANCOUVER
From The Economist print edition

A knotty question of trade law

Get article background

RARELY are Canadians as angry with their American neighbours as when they are squabbling over timber. Their 20-year trade dispute might have come to an end last month, when Canada won a supposedly definitive ruling under the North American Free-Trade Agreement (NAFTA) ordering the United States to drop its punitive duties on Canadian softwood and refund around $4 billion already collected. But the United States refused to comply and, later in the month, won support for its stance from the World Trade Organisation (WTO). Outraged, Canada has cut off talks with the United States on the issue.

American timber firms complain that Canadian rivals, who cut trees mostly from publicly owned forests, pay artificially low cutting fees that amount to an unfair subsidy. Three years ago, the United States imposed hefty duties on Canadian lumber, prompting Canada to complain under NAFTA. After several rounds of sparring, a NAFTA panel last year made a “final” decision to reject the United States' case.

However, the United States launched an “extraordinary challenge”, claiming the procedure had been flawed and that one of the panel's members had a conflict of interest. Nevertheless, NAFTA's extraordinary-challenge committee last month upheld the panel's final verdict. When the United States rejected even this ruling, rancour exploded in Canada, and members of Parliament started baying for retaliation.

The United States' new ambassador to Ottawa, David Wilkins, did not help by telling Canada's politicians to stop their “emotional tirades” and come back to the negotiating table before things descended into an all-out trade war. Firing back, David Emerson, Canada's industry minister, called Mr Wilkins “hypocritical”, because Canada had spent years negotiating to no avail, and “a bully”.

The Bush administration says it rejects the NAFTA panel's verdict because it is based on out-of-date facts. The panel was passing judgment on a declaration by the United States in 2002 that Canadian softwood was unfairly subsidised. However, changes were made to this declaration last year, to satisfy objections raised by the WTO. Last month the WTO announced that it was indeed satisfied with these changes (though it still quibbles with the Americans' figures for the size of Canada's alleged subsidies).

Look, says the United States, the NAFTA and WTO rulings conflict, so let's just negotiate a compromise. There's no conflict, snorts Canada, because the WTO's ruling has no legal force whereas NAFTA, being a treaty between the countries, is legally enforceable. Indeed, it intends to ask the United States' own Court of International Trade to make its government obey the NAFTA ruling. Meanwhile, Canada also plans an information campaign telling other countries seeking trade deals with the United States what it has learned about the value of its signature on a treaty.

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Japan

Koizumi on tour

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From The Economist print edition

AP

The rock-star prime minister tries for another victory this weekend

IT IS an election without precedent in many ways, so the outcome on September 11th could yet defy the pollsters. But three days before the voting, the Liberal Democratic Party (LDP) held such a commanding lead in opinion surveys that it was widely expected to retain its grip on power, as it has done for all but ten months of the past half century. If you were to conclude from this, however, that the election has lost its suspense, you would be wrong.

For Japan's prime minister, Junichiro Koizumi, is taking on two very different opponents in the election that he decided to call a month ago, when his plan to privatise Japan's postal-savings bank had failed to clear parliament. One opponent is the group of LDP rebels who voted against the privatisation plan in the lower house, and who therefore represent one of the most ferociously anti-reformist wings of the party. Mr Koizumi's other opponent is the Democratic Party of Japan (DPJ), which has improved the country's democracy greatly over the past few years by giving the LDP some competition. Ideally, Mr Koizumi would destroy the rebels on Sunday without doing too much damage to the DPJ. Neither outcome is assured.

It is clear, though, that many of Japan's voters are energised, and mostly for reform. Mr Koizumi's attack on the rebels has clearly inspired much of the country. He has sharply boosted his standing in the opinion polls, and many young and urban voters who have shunned the ruling party in recent years now say that they support the prime minister and his purged LDP. Opinion surveys suggest that the Japanese are more keen to vote this time than they have been in many years. And normally apolitical onlookers are debating this election much more than previous ones.

Mr Koizumi has appealed to modernist voters in two ways. First, he has chosen a single issue, postal privatisation, as a litmus test of reform. Some may see this as odd, given that his plan for the privatisation of the biggest financial institution in the world is less radical that it sounds. The plan is greatly watered down, after all, and many economists argue that any benefits from freeing capital markets will probably accrue only slowly. Moreover, the DPJ is right in saying that its own agenda is much more reformist, on the whole, than Mr Koizumi's. And the DPJ is talking about issues, such as pensions, that worry most voters much more directly.

Yet many voters seem to understand Mr Koizumi's postal test better than the pundits do. Whether or not it is Japan's most urgent economic matter (Mr Koizumi says it is), it allows him to draw sharp lines within his own vague and cynical party, and to give Japan's voters a clear choice between two LDPs: the old one that he wants to destroy and a new one that he promises will be better.

Mr Koizumi says little about this new LDP, which will, if he wins, retain many of the familiar old members and connections. But his implicit message is that if the voters give him a resounding show of support, and help him to defeat the worst elements of the party, then it will embolden the modernisers who want to prise the LDP away from the grip of special interests. In the past it has proved difficult for voters to send that message to a faceless and unprincipled party. So Mr Koizumi has used the postal test to put names and faces to the problem.

He has also boosted the chances of his ploy working by adopting a second strategy: the “assassins”. Across the country, Mr Koizumi has enlisted popular and unforgettable candidates to challenge the old-guard LDP recalcitrants in their well-defended home districts. Many of them are women, including an economist at a foreign bank, a celebrity chef, a former Miss Tokyo University and a well-regarded cabinet member whom the media have even touted as an ideal bride for the divorced prime minister. All of them back postal privatisation.

Much of this smacks of gimmickry. But it has created a clear distinction in the public mind between the rebels, who want to cling to the old Japan, and Mr Koizumi's team, who represent many varieties of a new Japan. The tactic has also allowed Mr Koizumi to play the cool maverick, thus boosting his popularity in the way that his *Lion Heart* e-mail magazine and a CD of his favourite Elvis songs did after he first took office in 2001.

There is a big difference between now and then, however. In 2001, pundits worried that Mr Koizumi's popularity would wane once the media spotlight went off, and once voters started to shy away from his calls for reform. Now the worry is that he is still popular, but will not carry out as much reform as the voters want. Mr Koizumi has not changed all that much. The voters, though, have come a long way.

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Kashmir

Three legs good

Sep 8th 2005 | DELHI
From The Economist print edition

A tentative beginning to a dialogue between India, Pakistan and Kashmiris

Reuters

Prime minister meets mirwaiz

Get article background

MANMOHAN SINGH, India's prime minister, is often portrayed as a decent but weak-kneed man, constantly tailoring his reformist economics to the conservative cloth of party colleagues and coalition partners. In at least one sphere, however, he has taken bold steps: making peace with Pakistan. September 5th, for example, saw his first meeting, in Delhi, with a five-member delegation from the All-Party Hurriyat Conference, an umbrella group opposed to Indian rule in Kashmir, a divided state claimed by both countries.

"Small minds wanted to spoil this," says Saifuddin Soz, a member of parliament from Kashmir, who helped arrange the meeting. The prime minister, he said, had the "vision and courage" to ignore the hawkish voices of his own officials. The result of the meeting was encouraging. The Hurriyat delegation, led by Umar Farooq, the *mirwaiz*, or spiritual leader, of the Kashmir valley's Sunni Muslims, agreed that "all forms of violence at all levels should come to an end". Perhaps 80,000 people have died in the 16-year insurgency. Mr Singh agreed to a review of the cases of all those detained under anti-terrorist laws in Kashmir.

Nobody is cheering yet. Much the same was agreed at two meetings the Hurriyat held early last year with the previous Indian administration. The violence did not stop, though it has somewhat abated. And the government failed to deliver the promised improvements in human rights. Many Kashmiris, long cynical about India's motives, suspected it simply wanted to divide the Hurriyat and discredit its leaders.

Similar fears were evoked on September 6th, when nine women, led by a well-known separatist, who had been acting as an Islamic "moral force", campaigning against prostitution, and vandalising liquor shops, were charged under Kashmir's tough "public safety" act. The *mirwaiz* questioned the timing of the move.

But this time dialogue need not fizzle out acrimoniously as happened last year. Relations between India and Pakistan have continued their slow improvement, and Kashmir itself has benefited from some of the confidence-building measures, notably the opening this April of a bus-route between Pakistani- and Indian-controlled Kashmir.

Mr Singh and Pervez Musharraf, Pakistan's president, seem to trust each other. To placate his own hardliners, however, General Musharraf badly needs evidence that he is making progress over

Kashmir. By having allowed Hurriyat leaders to visit Pakistan in June, and by talking to them himself, Mr Singh is providing it. That is useful spadework for his next get-together with the general, in New York on September 14th. Three days later, the *mirwaiz* will also meet the Pakistani president there.

This Hurriyat delegation, however, represents only one section of anti-Indian sentiment—broadly speaking, a moderate-pro-Pakistani line. A harder-line faction, led by Syed Ali Shah Geelani, with support from hawks in Pakistan, has stayed aloof. So, for now, have leaders such as Shabir Shah and Yasin Malik, who, like many Kashmiris, want independence from both India and Pakistan. So this is only the beginning of a dialogue that needs to be broadened and deepened, before it can even begin to touch on the core issue: Kashmir's status.

Until that happens, Pakistan is loth to abandon the weapon it has long used to exert pressure on India: the infiltration of militants to help fight the insurgency. Indian officials say infiltration continues, though at lower levels than in previous years. Nor has Pakistan dismantled the networks that raise money and cannon-fodder for the war. That is why Mr Singh's gesture to Kashmiri separatists is unpopular among some of his own advisers. Amitabh Mattoo, vice-chancellor of the University of Jammu, in Kashmir, says the prime minister has shown he is prepared to take risks in order to be remembered as a peacemaker. Peace would be an achievement worth even the sacrifice of a few economic policies.

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Nepal

Heat on the king

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A Maoist ceasefire turns up the heat on King Gyanendra

IT WAS, for many Nepalis, the first pleasant political surprise in ages. On September 3rd Maoist insurgents announced a unilateral three-month ceasefire in their nine-year war with the government. If it held, this would be the longest lull in violence since peace talks collapsed in 2003.

Nepal's political parties, sidelined when King Gyanendra seized power in February, were quick to give the ceasefire a guarded welcome. So were diplomats, the tourist board and many ordinary Nepalis. But the royal government remained silent for 48 hours. Then the government's spokesman said it was “too early to be sure” about the Maoists' sincerity.

The Maoists have not called the truce to make friends with the king. Their spokesman at first ruled out talks with the palace, saying the next step was to abolish the monarchy. Two days later, their reclusive leader, known as Prachanda, was less fierce, saying talks with the government might be possible. Some of the king's closest advisers are believed to be urging the king not to reciprocate the ceasefire, telling him it is a result of the army's successes. Outside the palace, though, most believe the ceasefire is a tactic to weaken the king.

The king has dropped reported plans to visit New York to address the special UN summit on reform next week, in the face of increasing diplomatic isolation and the removal, for now, of the main pretext for his February coup—the need to quell rebel violence.

The Maoists are courting the two main parties, which recently dropped their support for a constitutional monarchy and said they would talk to the rebels if they stopped fighting. In Nepal's triangular struggle, unity between the parties and Maoists could bring the king down. But for many Nepalis, fed up with all three sides, the real issue is whether the bloodshed stops. They may be disappointed. The army says the Maoists have already broken their truce several times, killing at least two people. It also admits killing two rebels itself. And the Maoists say they will “resist” if attacked.

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Economist.com WORLD ASIA

Asian textiles

A stitch in time

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China's clothing trouble is good news for South-East Asia

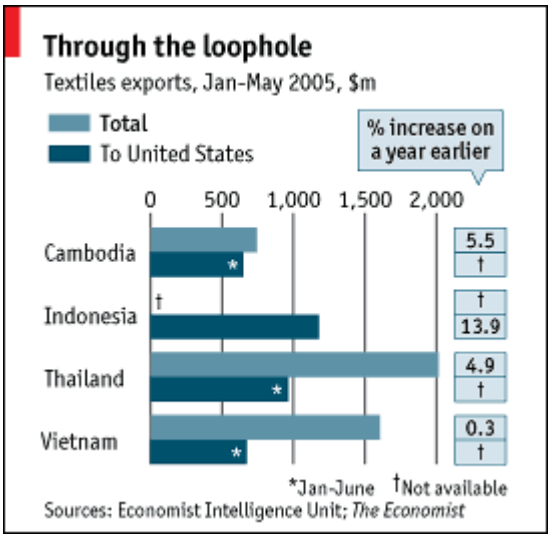
THE deal reached by China and the European Union on September 5th must have brought cheer to the clothing factories of South-East Asia. Clothing quotas were supposed to have been scrapped for good among members of the World Trade Organisation at the beginning of the year, but the EU reimposed them in June. Under the new agreement, the EU will maintain import quotas on certain categories of Chinese-made clothes until 2008, although it will admit the quota-busting Chinese sweaters and trousers that had been piling up in European ports, in exchange for a reduction in next year's ration of exports. Since America is also imposing quotas on China, South-East Asian exporters now face much less competition, at least for a while. Governments in the region are still, however, pursuing a variety of strategies to save their clothing industries from oblivion in a quota-free world.

The now-postponed decision to scrap quotas prompted fears that low-cost Chinese competition would wound the clothing industry in pricier places such as Thailand and Indonesia, and kill it off altogether in countries like Cambodia, where it had sprung up solely to take advantage of the quota system. That, in turn, would put billions of dollars in export earnings and millions of jobs at risk. In Cambodia, to take the most alarming example, clothes make up almost 80% of all exports, and help support as much as a fifth of the population.

Cambodian clothes-makers are no longer trying to compete with China solely on price. Instead, they have been trying to build a reputation for strict labour standards that might appeal to western firms not wishing to be associated with sweatshops. The Cambodian government has passed elaborate labour laws. Inspectors from the International Labour Organisation monitor compliance, often through spot checks. According to a survey by the World Bank, the scheme is a hit with customers, including big retailers such as Gap.

Thailand, too, will try to avoid competing with China on cost, chiefly by raising the quality and value of its exports. The government wants to turn the country into a hub, where local companies do not just make clothes under contract for foreign retailers, but also design and market products of their own. Last month it organised “Bangkok Fashion Week”, complete with a floating catwalk under an inflatable dome, to show off the work of Thai designers.

Indonesia, meanwhile, is in the midst of a broad campaign to improve the local investment climate, and hence stem the flight of manufacturers to more accommodating jurisdictions. The government has recently tackled some of the most common complaints by scrapping onerous provisions of the labour law and reducing the power of local governments to levy arbitrary fines and fees. It is also trying to reduce corruption and red tape.



It is hard to measure the impact of any of these schemes. Other factors, such as depreciating local currencies, may have a bigger effect. Whatever the reason, clothes exports from the region are not just holding their own in the face of Chinese competition, but actually increasing (see chart). Moreover, the increase precedes the reimposition of quotas on Chinese exports by America and Europe.

The odd man out is Vietnam. It is not yet a member of the WTO—though it is trying to join—so still faces quotas on its exports to America. But it will struggle to fill them this year. On the whole, Vietnam's exports are booming, since its wages are lower even than China's. But as its South-East Asian rivals in the clothing trade have shown, price is not everything.

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Chinese taxes

Raising the bar

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Too many people pay, and the rich don't pay enough

Get article background

BY KEEPING its tax threshold absurdly low, China has in recent years created a rapidly growing group of citizens subject to personal income tax. Now at long last it appears to recognise that taxpayers should have a voice, albeit a very limited one.

On September 27th, the National People's Congress, China's legislature, will hold its first ever public hearing. Citizens have been invited to submit their views on a proposal to raise the income-tax threshold from 800 yuan ($99) a month, where it has been set for the past quarter of a century, to 1,500 yuan. The authors of 15 to 20 of these submissions will be selected to address the hearing.

Officials say raising the barrier to 1,500 yuan would reduce the number of income-tax payers (currently around 180m, estimates Liu Huan of the Central University of Finance and Economics) by 10% and income-tax revenues by 20 billion yuan a year. But few Chinese city-dwellers are likely to be impressed.

When the 800 yuan level was set, the average monthly urban income was only around 40 yuan (albeit with additional housing, education and health-care benefits that have now been virtually scrapped). The average income is now over 700 yuan a month, and much higher in big cities like Beijing and Shanghai. Many cities have already—with dubious legal authority—made their own adjustments to the tax threshold (in Beijing it is 1,200 yuan). Surveys conducted by the Chinese media suggest strong support for a threshold of at least 2,000 yuan a month.

Part of the proposed amendment to the income-tax law would require the rich to submit regular tax returns to the authorities, in addition to having tax deducted from their salaries like the less well off. This would be aimed at getting them to declare non-salary sources of income which few Chinese citizens bother reporting. But given the small size of China's income-tax bureaucracy compared with the ballooning number of taxpayers, evasion by the rich is likely to remain widespread. Mr Liu believes China fails to collect as much as half of income tax owed.

By opening up the income-tax issue to public debate, China's new generation of leaders is trying to reinforce the image it has wanted to convey in the past two or three years of being “close to the people”, especially the poor and marginalised. Since last year many parts of China have scrapped an agricultural tax on peasants.

But by consulting the public on tax issues, the authorities risk exposing themselves to embarrassing questions. *Xinmin Weekly*, a Shanghai-based magazine, published an article this week arguing that it was better to keep money in the hands of the public rather than hand it over to a government not subject to effective restraints on its spending, corruption or waste. “On paper, the constitution has bestowed some rights, but in real life the ordinary taxpayer cannot enjoy these. Taxpayers' rights should be strengthened in order to tighten supervision over the government's power,” it said. No taxation without representation, perhaps?

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The Philippines

Glory be

Sep 8th 2005 | MANILA
From The Economist print edition

The president escapes impeachment

Get article background

AFTER the Philippines' House of Representatives voted by three to one to dismiss the impeachment of President Gloria Macapagal Arroyo, she celebrated the resilience of the constitutional order and told her opponents, “I now offer my hand in reconciliation for the national interest.” Mrs Arroyo's opponents, however, showed no desire for reconciliation, indicating that they would continue their campaign to remove her, using methods that will further test that resilience.

The opposition had attempted to impeach Mrs Arroyo principally on the ground that she cheated in last year's presidential election. The main evidence against her is a set of recordings of telephone conversations in which, say her accusers, she and an election official conspired to rig the results. Mrs Arroyo denies that she cheated, and her supporters dispute the authenticity of the recordings. Her accusers first tried to raise a public clamour for the president's resignation. When she refused to go, they attempted to impeach her, but they were frustrated by her allies in the House.

The president's opponents must now, by law, wait one year before they can try again to impeach her. Some have decided to complain to the Supreme Court about the House's handling of the impeachment proceedings. Others have called for peaceful protests in the streets to press her to step down—in other words, a “people power” uprising of the kind that toppled two previous presidents, Ferdinand Marcos and Joseph Estrada. But despite some noisy demonstrations since the House vote, there appears to be little popular appetite for a revolution. The prevailing attitude towards Mrs Arroyo is one of cynical mockery, not indignant intolerance.

Although the constitutional order, and Mrs Arroyo's place in it, seem secure for now, both are likely to remain vulnerable while doubt remains about her probity. Even so, many Filipinos accept the familiar saying that their elections produce no losing candidates, only the winners and those who have been cheated. It looks as though it will take more than another tainted election to encourage them to overthrow the government.

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Economist.com WORLD ASIA

China

Democracy Idol

Sep 8th 2005
From The Economist print edition

A television show challenges the authorities

Reuters

CHINA is trying to digest the implications of a popular vote involving millions of people across the country. Never mind that the ballots were cast for contestants in a televised singing competition, and that only those with the means to send text messages by mobile phone could take part. A front-page headline last week in the state-run *Beijing Today* put the question with astonishing frankness: “Is Super Girl a Force for Democracy?”

In a country conspicuously lacking in democratic choice, this rare opportunity to vote and make a difference—even if only to the outcome of the “Mengniu Sour Yoghurt Super Voice Girl” competition—has inspired a remarkable debate. The discussion has been fuelled by huge public enthusiasm for the show, a programme similar to “American Idol” and its predecessor “Pop Idol” in Britain. It was broadcast by a satellite television station in Hunan province and relayed nationwide on cable networks. The organisers say some 400m people watched the final on August 27th—nearly a third of the population. Around 8m text message votes were cast.

“Super Girl”, as the show is commonly known, appealed mainly because of its racy format (at least until the authorities began insisting on more downbeat folksy songs) and the pleasure that many enjoy from watching amateur singers embarrass themselves. Rebellious young women apparently identified with the self-confident and boyish-looking winner, Li Yuchun. Groups of fans campaigned in the streets.

Some of China's more daring newspapers have seized on the chance to put “Super Girl” in a political context. An article widely carried on state media websites said the contest had caused Chinese intellectuals to “fantasise about arrangements for democratic elections and notice the awakening of democratic consciousness among the younger generation.” But the *China Daily* loyally expressed scepticism, asking, “How come an imitation of a democratic system ends up

selecting the singer who has the least ability to carry a tune?" That, of course, is democracy.

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Egypt

Only a first step, but it matters

Sep 8th 2005 | CAIRO
From The Economist print edition

America has encouraged the Arab world's most populous country to embrace the spirit, if not yet the full substance, of democracy

Get article background

THE fight was lopsided, hastily arranged, poorly refereed and pitted a big bruiser against bantams. Still, Egypt's first-ever multi-candidate presidential election marked a watershed, even though, from the start, the incumbent, Hosni Mubarak, looked certain to win. Perhaps more than any other recent Middle East event, from January's polls in Iraq to Lebanon's “Cedar Revolution”, the simple running of a public political contest in the oldest, largest and most archetypically autocratic of Arab states presages a speeding of the momentum for change in a region notable for political backwardness.

As in similarly novel elections for the top post over recent years in such Arab republics as Algeria and Tunisia, the incumbent could expect to sweep all rivals aside. But Mr Mubarak's presumed win, extending his term to 2011, is less significant than the scale of political ferment stirred by the campaigning itself.

After 24 unchallenged years in power and a vast state apparatus at his bidding, Mr Mubarak had a huge advantage. Yet his main rivals still got their message out in an unprecedentedly noisy barrage of speech-making and publicity. This did not inspire a large turnout. A legacy of deep cynicism, the barring of potentially popular Islamist candidates, and procedural obstacles to voter registration kept numbers down. But the spectacle of public, often impassioned criticism and the

very possibility of choice opened up new ways of thinking, focused minds on real issues, and emboldened activist groups already pressing for reform.

A palpable wonderment could be seen, for example, on the faces of passers-by who happened on the night-time rally in central Cairo that concluded one candidate's campaign. The backdrop, a hulking state-office complex that is a byword for immutable bureaucracy, was richly symbolic. Delivered in a voice hoarse from campaigning, the candidate's words seemed to touch a chord. “I've toured 15 out of 26 governorates, and not one single pane of glass was broken,” declared Ayman Nour, a canny member of parliament who, at 41, was the youngest challenger. “So how come we've been told for 24 years that we need riot police and emergency laws, that we aren't ready for democracy?”

Democracy is not quite what Egyptians have got. Mr Mubarak's regime, like the avowedly reformist ruling elites of nearby countries such as Jordan, Bahrain and Morocco, has yet to relinquish real control of the pace and scale of change. Its powers remain multiple and unchallenged, from the president's appointing of regional governors, mayors and village headmen right down to police officers' near-impunity from punishment if they maltreat suspects. “Three minutes of freedom” is what one Egyptian intellectual dubbed his country's 19-day official campaign period.

Not surprisingly, many Arabs suspect that reforms in Egypt and elsewhere are cosmetic, intended mainly to appease George Bush's administration, which actively preaches democratisation as a foil to extremism. This is not entirely fair. In Egypt, for instance, reformist currents have gained prominence within the ruling National Democratic Party, just as they have within ruling families in the Gulf. Some argue that their governments need democratic legitimacy, as much to enable them to stand up to America as to sell better the kind of liberal economics they believe to be the surest course to prosperity.

Other factors weigh in for change. Across the Arab world, demography, technology and communications have set off a revolution in expectations. Satellite TV presents clashing ideas, promoting a fresh culture of debate. The fading of the post-colonial generation of leaders and the failure of their pan-Arab project have led to a loss of prestige for the patriarchal power structure that has long characterised Arab states. To disfranchised youths facing such region-wide plagues as job and housing shortages, radical Islam has sometimes appealed. But the violent excess of extreme militants has prompted many to seek more practical solutions. Egypt's campaign rhetoric, for example, stressed domestic issues rather than the kind of perceived great injustices—Palestine, Iraq, Islam-bashing—that have traditionally grabbed the attention of the “Arab street”.

True enough, American pressure for democratisation has been inconsistent. The much-touted American aid programme to promote reform, the Middle East Partnership Initiative, gets less cash in a year than what America spends in Iraq in a day. Washington bureaucracy delayed funds for some democracy activists in Egypt. Others that did get American cash include groups seeking to monitor the elections, but a quasi-official election commission blocked them from doing the job.

Some of America's practices have also clashed with reformist goals. Its pursuit of terrorism by “rendering” suspects to torture-prone governments undercuts the many local groups lobbying to end such brutal practices. And rather than being hailed as a model for pluralism, Iraq is widely seen as a chaos to be avoided. Many Arabs view its new constitution as the outcome of an American plot to divide and rule. Aside from a few intellectuals who are feted in Washington but generally shunned in the region, most Arab reformers warm much more to the caustic critiques of the American film-maker Michael Moore than to George Bush's “forward strategy of freedom”. Most believe that, in the end, America's thirst for oil will exceed its democratic principles.

Yet there is little doubt that American influence has helped tip the balance of regional forces in

favour of reform. A coincidence, perhaps, but it was shortly after Condoleezza Rice, America's secretary of state, abruptly cancelled a scheduled visit to Egypt that Mr Mubarak announced his initiative to hold a contested presidential election. Later, speaking in Cairo, Ms Rice won over even a few Egyptian sceptics by appealing to their pride, suggesting that their country should lead the region in political progress as it has led before in pursuing peace. Lebanon's dramatic overthrow of veiled Syrian rule this spring was only made possible by American-led moves to de-claw and isolate Syria's regime. And these moves were made possible, in turn, by the toppling of Saddam Hussein.

And if the changes in many countries remain shallow, the whole floor of public debate has clearly shifted to questions of when and how rather than why to reform. This is true even of regional laggards such as Libya, Saudi Arabia and Syria, which have all taken wobbly first steps towards wider public participation in government. Where bigger steps have been taken, as in Egypt, the public appetite has been whetted rather than appeased. “This election was just a drill, which the government would never have accepted without foreign badgering,” admits an Egyptian official. “But it's set the stage for parliamentary elections that may get really interesting.” These are due in November. If debate stays lively until then, a lot more Egyptians may actually bother to vote.

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Economist.com WORLD AFRICA & MIDDLE EAST

Palestine

Murder and fragmentation

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The killing of an Arafat demonstrates chaos within the Palestinian Authority

AFP

His uncle's spirit didn't help

LOTS of people had a reason to want to kill Musa Arafat; lots had already tried. As a cousin of the late Palestinian president, Yasser Arafat, and head of military intelligence for the Palestinian Authority (PA), he had enjoyed a reputation for brutal methods, a long list of enemies, and complete untouchability. Having been removed from the job by Mahmoud Abbas, who succeeded his relation as president, Musa was left with the largely titular role of presidential adviser and much free time to get involved in factional disputes within the Palestinians' ruling Fatah movement.

The ones who at first claimed responsibility for killing him in the small hours of September 7th and abducting his son were the Popular Resistance Committees, a militant group formed originally by disgruntled members of the PA security services, but whose attacks on Israeli targets had recently been getting support from the militant wing of Hamas, the Islamist chief opposition to the PA.

Later, however, the committees retracted their claim. And the manner of the murder suggested the collusion, or at least indifference, of others. Mr Arafat's house is within shouting distance of the Gaza offices of the president, the prime minister and Muhammad Dahlan, the PA's civil-affairs minister and Gaza's most powerful man. The attack was the work, according to witnesses, of a large and well equipped force: at least 100 men arrived in some 20 vehicles. Police took three hours (ie, not until long after it was over) to come to the scene of a fierce battle that must have woken half of Gaza City, including your correspondent. Official television was for a long time silent too, as were most PA officials.

Mr Arafat's demise also means one less thorn in the side of Mr Abbas, whose attempts to push through changes in the security services, in Fatah and in the PA as a whole, have been hampered by members of the Fatah old guard, Mr Arafat among them. But such a bare-faced attack, underscoring the impunity with which armed groups operate, undermines Mr Abbas's attempts to impose his authority. He has had to cancel his trip to next week's UN summit in New York.

Ironically, a conflict that had been brewing between the PA and Hamas, since the PA postponed a general election scheduled for June, has been more quiescent, and they co-operated to ensure a relatively peaceful mood for Israel's withdrawal of settlers from Gaza. Mr Arafat's murder, on the heels of a rash of kidnappings by factions, suggests that the biggest threat to stability may not be the Islamists. Their plan remains to defeat Fatah at the ballot box rather than on the street (the election is now due in January). The biggest threat is the seemingly unstoppable fragmentation of the PA and Fatah themselves.

Economist.com WORLD AFRICA & MIDDLE EAST

Nuclear diplomacy

The case against Iran

Sep 8th 2005
From The Economist print edition

Strengthening or weakening?

Get article background

WHY is the pressure suddenly seeming to leak out of the diplomacy to persuade Iran to end its nuclear dabbling—just when the regime is flaunting its defiance? Despite frantic lobbying that will continue at next week's United Nations summit in New York, Britain, France and Germany are struggling to keep up support for efforts to coax a recalcitrant Iran to give up—or else!—its plans to enrich uranium and make plutonium, two ingredients of civilian nuclear fuel that can also be fashioned into the fissile core of a bomb.

Inspectors from the International Atomic Energy Agency (IAEA), the UN's nuclear guardian, confirmed this week that Iran has resumed work at its uranium-conversion plant at Isfahan, where uranium ore is turned into gas, ready for later enrichment. That breaks Iran's agreement with the Europeans, bringing months of talks to an end. They now want the IAEA's 35-nation board, when it meets on September 19th, to report Iran to the UN Security Council—something it should have done two years ago, when two decades of nuclear deception first came to light, but deferred to give diplomacy a chance. Now Russia, among others, is balking. So is Iran about to shake off all nuclear restraint?

Its new president, Mahmoud Ahmadinejad, will make new proposals, possibly next week in New York, that his officials claim will reassure the world about the peaceful nature of its nuclear programme. Yet conversion work will continue, they insist; future talks can cover the conditions under which Iran will resume full-scale enrichment work in the fast-spinning centrifuges it had already been building at Natanz before inspectors were tipped off three years ago.

Iran has played nuclear hardball like this with the Europeans before, only to beat a retreat in the face of concerted diplomatic pressure. But on this occasion the Europeans themselves acknowledge that, as the diplomatic clock runs out, consensus on the issue at the IAEA is starting to weaken.

Venezuela, increasingly friendly with nose-thumbing Iran, is unlikely to go along with the Europeans. Others, such as Brazil and South Africa, are critical of Iran but leery of reporting it to the UN for activities that are not explicitly ruled out by the Nuclear Non-Proliferation Treaty (NPT), and that they have an interest in pursuing themselves. So Iran has been pressing what it claims is its right to fuel-making technologies under the treaty.

In fact, the NPT promises only the benefits of civilian nuclear power to its members, not particular technologies, and only to those with a nuclear programme under proper IAEA safeguards. The Europeans have offered Iran safer nuclear technologies. Russia is already contracted to supply fuel to Iran's one nuclear power reactor, at Bushehr, and would happily do more. Other countries use nuclear power without making their own fuel.

Timetables for breakout

Yet what's the rush? In a report this week, entitled “Iran's Strategic Weapons Programmes”, the London-based International Institute for Strategic Studies concludes that, even without technical hitches, Iran is still some five years from having enough highly enriched uranium at its declared nuclear facilities for its first bomb (America thinks it might take the Iranians longer; Israel thinks they could do it a bit faster). But that assumes Iran has no secret enriching under way. If it has, skills acquired by restarting nuclear work the inspectors know about could help it break out of the NPT more quickly.

So suspicions about Iran's nuclear ambitions continue. This week the IAEA once again documented Iran's past nuclear transgressions: failing to account properly for importing enrichment equipment and materials from the nuclear black market; secretly enriching uranium and separating plutonium; and experimenting with polonium and attempting to import beryllium, two materials with civilian uses that also can be used as triggers for bombs.

Though reasonably sure that the traces of highly enriched uranium they found came from black-market equipment from Pakistan, the IAEA's inspectors still have no explanation for extra traces of the low-enriched sort. They cannot, they say, be certain that there are no undeclared nuclear materials or activities in Iran.

Yet even some of those sceptical of Iran's nuclear motives fret that referral to the Security Council might not help. Iran has already been growling about disrupting oil supplies through the Gulf. If pushed, it could end co-operation with the IAEA. North Korea's even more flagrant breaches, and then its withdrawal from the NPT, were reported to the UN, but China blocked further discussion. Will Russia do the same for Iran?

The Europeans are keen to show this is not an argument between themselves and Iran, but between Iran and all who would uphold the NPT rules. Russia had been quite helpful. But this week its foreign ministry—saying now was not the time to involve the UN—set a different tone. So Russia's Vladimir Putin, like China's Hu Jintao, can expect an earful about Iran from President George Bush in the wings of next week's UN meeting.

Would bringing Iran to the UN simply give America or others an excuse to take extreme measures, even using military force? The Europeans insist their aim is to strengthen the authority of the IAEA and its inspectors, not to usurp it. But they have a lot of persuading to do.

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Economist.com WORLD AFRICA & MIDDLE EAST

Zimbabwe

He's still there

Sep 8th 2005 | JOHANNESBURG
From The Economist print edition

President Robert Mugabe may be off the IMF's hook—for now

Get article background

Reuters

Gimme the cash

ON SEPTEMBER 9th, the IMF is to decide whether to expel Zimbabwe from its ranks for not paying its debt and for grossly mismanaging the economy. The country has not received any money from the IMF since 1999 and has already lost its right to vote on the board. But last week, in a surprise move, its government paid $170m out of the $295m or so it owes the Fund. Whether or not this is enough to reverse the automatic expulsion process, it may persuade the IMF board to postpone a final decision for another six months. While the payment may make life even more miserable for ordinary Zimbabweans, it may give their beleaguered president, Robert Mugabe, further means to go on ignoring foreign pressure.

His government made the last-minute effort to find the money itself in order to avoid having to rely on South Africa to tide it over. President Thabo Mbeki looked as if he would come to his neighbour's rescue once again, with a loan; but this time it would have had strings attached, marking a distinct shift in policy. Loan negotiations were said to have included insistent chats about economic and political reform, though the South African government has been loth to talk about “conditions”.

So Mr Mugabe and his ruling ZANU-PF may breathe again, at least for a while. They have said that talks with the opposition, thought to be part of South Africa's demands, are out of the question. On August 30th, the parliament, controlled by the ruling party, amended the constitution: a senate is to be created, landowners will no longer have legal recourse against expropriation, and opponents can be stripped of their passports.

Mr Mugabe's efforts to find money elsewhere seem to have largely failed. His recent trip to China has not produced the cash he had hoped for; no other country seems keen to sign a cheque. Despite China's interest in minerals, Zimbabwe is of no great strategic importance; Mr Mugabe's “look-East” policy is unlikely to bring the investment so badly needed.

The government made the IMF payment by mopping up just enough foreign exchange from local exporters. As a result, unless some more hard currency shows up quickly, food and fuel shortages may get worse; this week the price of petrol doubled. In an effort to fend off the continuing crisis, Zimbabwe's official exchange rate was devalued in June, interest rates nudged up and measures to cut the budget deficit were announced. But overall the economy is still a mess; it will take more than monetary and fiscal tinkering to stop descent into total ruin. The country's GDP has shrunk a third since 2000; inflation, at last count, was running at 254% a year. About a quarter of

Zimbabwe's estimated 12m-plus people are thought to have emigrated. The UN says that Mr Mugabe's recent drive to “clear out” the cities by expelling black-marketeers and destroying houses said to have been built without permission has left at least 700,000 more people destitute.

Getting by on nothing

The suffering of ordinary people is growing. The UN World Food Programme reckons that 4m of them will need food aid by March, but is short of funds. The South African Council of Churches collected blankets and food to support those left homeless by the government's urban clearances, but distribution has been delayed by government demands for proof that the food has not been genetically modified and by extra paperwork over import-duty exemption. Lack of foreign exchange may eventually force Mr Mugabe to start making concessions to his critics. But Zimbabwe's people may have become inured to their hardship, and some bits of the economy—mining, for instance, which brings in hard cash—still function. It is difficult to say when the government will run out of money completely.

Neither sanctions by the European Union and the United States nor South Africa's soft approach have persuaded Mr Mugabe to change course. He has rebuffed an attempt by Nigeria's president, Olusegun Obasanjo, the African Union's current chairman, to send an envoy to talk sense into him. And the prospect of Zimbabwe imploding in chaos on its doorstep may weaken South Africa's new resolve to squeeze Mr Mugabe. Without more pressure from abroad, especially from South Africa, Mr Mugabe can concentrate on squashing opposition at home. Despite the growing misery around him, he does not seem to be on his last legs yet.

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Economist.com WORLD AFRICA & MIDDLE EAST

Uganda

The war against AIDS and condoms

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The shine is coming off what was once hailed as triumph of government policy

AIDS has killed about 1m Ugandans, while some 1.1m may still be infected with HIV—big figures in a population of 27m. But by African standards, alas, they are something of a success story. Much of the credit has gone to Yoweri Museveni, president since 1986. But now the campaign against AIDS is faltering amid accusations of moralistic grandstanding and financial mismanagement.

Don't show them to the First Lady

In the 1990s, western donor governments lauded Uganda for setting the standard in the continent's fight against AIDS. Mr Museveni talked openly about the disease, when many of his peers remained silent. He also pioneered the now famous “Abstain—Be faithful—use a Condom” (ABC) campaign that showed Ugandans how best to protect themselves. Partly as a result, infection rates fell from 18% in the 1980s to 6% in 2003.

But the AIDS problem is worsening again. A Ugandan health-ministry survey suggests that the infection rate is going back up to 7% for men and 9% for women. And just as Mr Museveni basked in the praise during the good times, now he—and particularly his wife Janet—are taking the blame as things go sour. For they have been accused of promoting the A at the expense of the C, partly under American pressure. As a result, the disease is spreading once again—a charge repeated last week by the UN's special envoy to Africa on AIDS. The government denies any change in policy, but critics point to several interlocking trends.

Since Mr Museveni made a speech strongly attacking condoms last year, say campaigners, primary-school children are no longer taught about condoms, which are no longer prominent in public advertisements. This chimes with the campaigning of the president's wife, a vocal evangelical Christian and condom-basher, who funds pro-abstinence and pro-fidelity posters and radio spots, and has called for a census of virgins in the country.

Bolstering that approach is the (American) President's Emergency Plan for AIDS Relief (PEPFAR), which explicitly promotes abstinence and has pumped in more than $230m to the country since 2003. Uganda, say campaigners, is dancing to America's tune, so condoms are no longer a key part of public policy. That disgusts many Ugandans, who contend that all three prevention options—A, B and C—must have equal priority . “We're not fighting HIV any more,” complains Beatrice Were, an HIV-positive campaigner. “We're fighting each other.”

This has led many to question why the government is storing 30m condoms that it used to

distribute free. There was a safety scare about a batch of holed ones late last year, but critics fear the government has used worries about a few of them to scare people into not using any.

On top of this, the Global Fund to Fight HIV/AIDS, Tuberculosis and Malaria, which held a big conference this week in London (see article), has suspended $155m in grants to the government, citing a loss of $280,000 in irregular “exchange transactions”. It marked another embarrassment for a country whose mantle of success is slipping.

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France

Braced for change, looking for a leader

Sep 8th 2005 | PARIS
From The Economist print edition

As fears grow over the president's health, his lieutenants compete to lead France out of its doldrums

Get article background

HOSPITALISED presidents make the French uneasy. François Mitterrand hid his cancer behind false medical reports for over a decade until his first operation, in 1992; he died four years later. Georges Pompidou's cancer became public only after his death from it while in office. So the news that President Jacques Chirac was to spend a full week in hospital, after a “small vascular incident” in the brain which affected his vision, prompted much speculation about the 72-year-old's health. If the problem is as minor as officials say, in formal terms nothing should change. But, symbolically, everything has.

Even before his hospitalisation, Mr Chirac had become politically enfeebled after the French rejected the European Union constitution in May. At the same time, his new prime minister, Dominique de Villepin, has been growing in stature. This week, that impression intensified, as Mr de Villepin chaired the weekly cabinet meeting usually presided over by Mr Chirac. More than ever, the Chirac era seems to be drawing to a close. And two of the men competing hardest to offer a fresh alternative are from his own Gaullist political family: Mr de Villepin and Nicolas Sarkozy, an ambitious interior minister, and head of the ruling UMP party.

Since politicians returned from their summer break, the pair have been competing to upstage one another. In a speech last week, Mr de Villepin unveiled a new phase of reforms, including the promise of income-tax cuts in 2007. Mr Sarkozy replied with two separate speeches this week,

launching his own raft of proposals, and declaring that “nothing, and nobody, will stop me going all the way”. At the party's summer school, in front of the television cameras, Mr de Villepin kept Mr Sarkozy waiting in a beachside café while he jogged along the sand and dived into the ocean. Until recently, it seemed the popular Mr Sarkozy had no credible rival on the right. No longer. One poll this week put Mr de Villepin's popularity as a potential 2007 presidential candidate at 57%, second only to Mr Sarkozy, at 63%.

In political style, the two men could scarcely differ more. Mr de Villepin is aristocratic, polished, a diplomat. Mr Sarkozy is pugnacious, plain-talking, a lawyer. Conventional wisdom has it that their politics are wide apart too. Loyal to the president whom he served for seven years as chief-of-staff, Mr de Villepin is his political heir. But Mr Sarkozy, who backed a rival candidate against Mr Chirac in 1995, has always marked his political distance from the veteran Gaullist. Yet a close look at the two politicians' speeches this week hints at something new: Mr de Villepin has begun to steal some of Mr Sarkozy's clothes.

Breaking taboos in a welfare-cushioned society, the prime minister declared that he wanted to “restore the value of work” and “make work pay”; Mr Sarkozy talked of the need to “make work central” and to reward “the France that gets up early in the morning”. Mr de Villepin vowed to crack down on welfare fraud and to balance welfare “rights and obligations”; Mr Sarkozy insisted that there would be “no rights without equivalent obligations”. Mr de Villepin said he would end heavy taxes that “discourage work and damage the attractiveness of our country”; Mr Sarkozy called for a limit of 50% on combined personal taxes and insurance contributions. Both promised help for the middle class.

To be sure, these similarities are quite differently wrapped. Mr de Villepin says he wants only to “set the French model straight”, whereas Mr Sarkozy intends to “reinvent a new French model”, that “breaks with the past 30 years of traditional political life in this country”. Yet the trend is nonetheless striking. Already, Mr de Villepin has introduced a new, more flexible two-year employment contract for small firms, addressing the problem of labour-market inflexibility that Mr Sarkozy so often bemoans. And he has declared himself against Turkish entry to the EU, another of Mr Sarkozy's pet positions—in line with public opinion but against Mr Chirac's (and hence France's) position.

Why this apparent quest for a radical alternative from within the president's own party? The answer lies partly in the war of succession: after this week, a third term for Mr Chirac must surely be ruled out. But also in the electorate's general disgruntlement, which partly explains the French “no” earlier this year. Unemployment has begun to drop a little, to 9.9%, but remains structurally high. Fears about job losses are undermining confidence at a time when the cost of living, worsened by high oil prices, is already squeezing purses. The economy is expected to grow by only 1.5-2% in 2005. And, after ten years with Mr Chirac in the presidency, there is a sense that it is time for a change.

As always, the difficulty is only partly in agreeing what reforms are needed. The harder question is how to bring them about. In many ways, the mood in contemporary France feels similar to that of Britain in the late 1970s. A political discourse of anti-capitalism has taken hold, accompanied by revolutionary communist and Trotskyite movements reminiscent of Britain's Militant Tendency and other hard-left class warriors in the 1970s.

Populist egalitarianism is preached with little regard for wealth creation. Union leaders are household names, and enjoy an influence disproportionate to their numerical importance in the workforce. (For the French firebrand José Bové, think Arthur Scargill, the noisy leader of Britain's miners). Intermittent paralysing strikes and street demos are regarded as normal (a widespread strike has been called for October 4th). Politicians promise “economic patriotism” and fear de-industrialisation. State-owned giants such as EDF, the electric-power utility, are considered

national treasures, as British Steel and British Coal once were. A bloated state saps public finances. And the country is infused with a mentality of decline.

Plainly, the parallel is not perfect. France is not facing the financial crisis that forced Britain to borrow from the IMF in 1976. Its private companies are in fine form, which was not the case for corporate Britain at the time. But there are enough similarities to prompt hard questions for France. If there is no crisis to match the one that led the British to elect (and re-elect) Margaret Thatcher, are the French nonetheless prepared for uncomfortable change? After all, much of this civilised, well-kept country, of high-speed trains and sit-down lunches, does not behave like a place on the edge of the precipice. Mr Sarkozy, for one, believes his compatriots are ready. “The French”, he declared, “are not afraid of change; they are hoping, waiting, calling for it.” The question then is: who best incarnates it?

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Economist.com WORLD EUROPE

Germany's election

Vote for my professor

Sep 8th 2005 | BERLIN
From The Economist print edition

A controversial economist is both an asset and a liability

Get article background

AP

Call me Kirchhof, I mean Ronnie

“AS EXPECTED.” No German newspaper actually used this headline for the television debate on September 4th between Chancellor Gerhard Schröder and his challenger, Angela Merkel. But it would have been fitting. Mr Schröder, a television pro, performed better; Ms Merkel was less eloquent, but did a bit better than many had feared. As expected, most pundits called her the relative winner, while pollsters put Mr Schröder ahead (50% of viewers, on average, found Mr Schröder “more convincing”, a view that only 30% held of Ms Merkel). And, as expected, the debate made a grand coalition of her Christian Democrats (CDU) and his Social Democrats (SDP) a bit more likely. (As further evidence for that theory, at least one poll now shows that the CDU and the Free Democrats can no longer be sure of a combined majority.)

Still, in two ways, the event was memorable. In her final statement, Ms Merkel repeated almost verbatim the question put by Ronald Reagan in his debate with Jimmy Carter in 1980—asking whether “our country is better off than it was seven years ago”. More remarkably, the discussion focused less on the election than on one man: Paul Kirchhof, an ex-judge who wants a 25% flat tax. Mr Schröder spoke of “this professor from Heidelberg” bent on ruining Germany's social-market economy. Ms Merkel likened him to Ludwig Erhard, father of Germany's economic miracle. A journalist asking questions made the slip of calling her “Ms Kirchhof”.

This episode suggests that Germany's election campaign has at last found its big issue, in the person Ms Merkel has recruited as her future finance minister. Hardly a day passes without his making the headlines. How many tax loopholes and subsidies does he want to get rid of to finance his flat tax? (He says 418.) Will he really get this crucial job? (Although Ms Merkel insists he will, there are doubts.)

Why this Kirchhof craze? The man himself is part of the answer. The 62-year-old stands out now merely because he is so tall. He is professorial in a good sense: a bit stiff and long-winded, but intellectually inspiring, not wonky. He likes to paint the big picture with broad gestures and vivid language. To him, German tax law is a fast-growing weed that has covered the “garden of freedom”. Previous reform efforts tried to fix “a car that is beyond repair”.

Although only a quarter of Germans understand Mr Kirchhof's reform plans, politics has made him the star of the campaign. Ms Merkel needed him not just to make people forget the weak start of her campaign, but to give her shadow cabinet some economic competence. Mr Kirchhof has served her as a floater of trial balloons; he can say things she would never dare to. Conversely,

government politicians (as well as Ms Merkel's rivals in her own party) have started to use the professor as a punchbag in an effort to hurt her.

Until the debate, the political benefits of using Mr Kirchhof had outweighed the costs. But the balance has now begun to tip. The professor, who has little political experience, has proved a loose cannon. Although his flat tax could not take effect before the next election in 2009, because Ms Merkel wants an intermediary reform first, he keeps talking about the tax privileges he wants abolished. In one interview, he also called for the privatisation of public pensions, causing another stir. Ms Merkel reportedly told him to mind his mouth.

Even if Mr Kirchhof became a political liability, he is unlikely to throw in the towel before the election. But there are growing doubts whether he has the political skills for the finance portfolio, the most difficult of the lot, given a budget deficit put at €60 billion ($75 billion) next year. Were he to go back to Heidelberg that would raise questions about Ms Merkel's reformist drive. Yet it could spare her the problem of having to change finance ministers.

A speedy departure might also save Germans from another disappointment. His flat tax is elegant (“beautiful”, he says), but he is naive about its prospects. He may share the fate of another non-political expert hired to solve a big problem: Peter Hartz. The ex-personnel chief at Volkswagen, who headed a commission to “modernise the labour market”, became a symbol first of Mr Schröder's drive to cut unemployment, then of its failure.

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Italy's central banker

You might think about going now

Sep 8th 2005 | ROME
From The Economist print edition

Antonio Fazio proves hard to unseat

NOT since Rasputin haunted the family of the tsar has it taken so long to dismiss an unwanted courtier. Antonio Fazio, governor of the Bank of Italy, was this week still clinging indignantly to office despite all attempts to make him resign. The latest came from the prime minister, Silvio Berlusconi, who, after weeks of dodging the issue, intimated that he too thought the governor should go. Mr Fazio has been accused of unfairly favouring local bidders over foreigners in two banking takeovers. He denies any wrongdoing.

The affair has weakened the credibility of the Bank of Italy and revived suspicions of a cosy, protectionist culture in the Italian elite. That has implications not just for prospective investors in Italy, but also for Europe's single currency, which relies for success on increasingly free capital movement. The affair's political effects have been almost as big as the financial ones. It has highlighted the splits in Mr Berlusconi's coalition which frustrate decisions.

When the prime minister at last censured Mr Fazio this week, he used a Dickensian circumlocution: the verdict of his finance minister, Domenico Siniscalco, that the governor ought to go was a view (albeit a personal one) that could “in many ways” be “considered well-founded”.

Without changing the law, the government cannot sack the governor, who has life tenure. But it could make his position untenable, either by issuing an agreed statement calling on him to step down, or by exerting pressure on the council which appoints the governor and can, in exceptional circumstances, dismiss him.

So far, the government has done neither and, as so often, the problem is with the smallest of the four main coalition parties. Mr Fazio's key ally has been Umberto Bossi's Northern League. Xenophobic and protectionist, its leaders back his alleged efforts to shield local institutions. Both banks involved, Banca Antonveneta and Banca Popolare Italiana (formerly Popolare di Lodi), have northern roots.

Though short on electoral backing, the League is vociferous, and ready to wreck the coalition if it does not get its way. It enjoys much influence over Mr Berlusconi. He has long felt that his own party, Forza Italia, could face mass desertions if his government were seen to ignore the north, its fragile small firms or their bankers.

His, and the League's, reluctance to take sides against Mr Fazio explains why the government appeared to prepare a bill to get rid of the governor, then approved one that didn't. On September 2nd, the cabinet agreed to a new, seven-year term limit—but only for Mr Fazio's successor.

That and other measures to shift some powers from the central bank to the anti-trust authority and the stockmarket regulator are to be included in a bill, drawn up after the 2003 Parmalat fraud scandal, that is aimed at boosting investor confidence. But the bill's tortuous passage has largely had the opposite effect, and there is a risk that, made yet more complex by the new provisions for

the Bank of Italy, it will not pass before the general election due next May. For the rest of 2005, the government will need most of its legislative time for the 2006 budget, and what's left is likely to go on a constitutional reform designed to satisfy the League's federal cravings. These demands on government attention also affect Mr Fazio's chances; for unless it acts soon, it could be too busy to act at all.

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Ukraine's crisis

Orange fades

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As Ukraine's revolution loses steam, a president sacks his government

WINNING power is the easy bit. Wielding it properly is much harder. That is the lesson for the victors of Ukraine's orange revolution. Squabbling and scandals among the country's new rulers have shrivelled the high hopes of the demonstrators who braved the freezing streets of Kiev to remove the corrupt and incompetent old guard from power last year. Now those squabbles have boiled over. Top aides to the president, Viktor Yushchenko, have resigned amid swirling allegations of corruption. And on September 8th he sacked the government, led by the fiery, erratic prime minister, Yulia Timoshenko.

Things had looked wobbly for months. Economic reform had stalled—partly, say people who tried to advise the government, because of Mrs Timoshenko's gnat-like attention span, and also because of deep divisions within the government between those who genuinely wanted to reform the country and those who wanted merely to rejig the old arrangements to their advantage.

In particular, much time and energy were spent on the question of the allegedly fraudulent privatisations of Ukraine's heavy industry under the old regime. Some in the new government seemed more interested in score-settling and asset-grabbing than fairness. Huge sums were at stake, and the desire of Ukraine's oligarchs to hold on to their gains, ill-gotten or not, may be at the root of the current upheaval.

Mr Yushchenko also failed to live up to his stellar reputation as a reformer (which always mystified those who remembered his undistinguished stint as prime minister). He did make some stabs at reform: sacking the country's entire traffic police, who were detested for their corruption, was a high point. But his own reputation has frayed. His son's extravagant lifestyle (involving tycoon's toys like a $40,000 mobile phone) came under close scrutiny; contradictory and angry responses from Mr Yushchenko and others made matters worse.

In the past week, the president's inner circle started disintegrating. Oleksandr Zinchenko, his impressive chief of staff, resigned claiming that other advisers had organised an “information blockade” around the president, in order to “use government posts to get their hands on everything they can”. He explicitly named the national security secretary, Petro Poroshenko, a controversial figure who has at times seemed to run a private foreign policy at variance with Mr Yushchenko's pro-western orientation. Mr Poroshenko and a colleague resigned shortly before the whole government was sacked.

The political capital of the orange revolution has been eroded but not exhausted. That is inevitably worrying for most Ukrainians, and their western friends. Only in Moscow, which dislikes revolutions in odd colours, will this week's events provide some satisfaction.

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Religion in the Balkans

Rendering unto Caesar

Sep 8th 2005 | DECANI, KOSOVO
From The Economist print edition

In several Slavic Orthodox places, religion and politics are badly entangled

UNLIKE many of Europe's cultural treasures, the monastery of Decani—a lovely mix of Romanesque architecture and Byzantine art—faces little risk from changes in the physical environment. In this wooded valley at the foot of a forbidding mountain, there is no ecological challenge comparable to the acid rain that erodes cathedrals in Cologne and Cracow.

Yet the 30 Serbian monks who man this 700-year-old redoubt face far more lethal dangers than that. Having suffered several mortar attacks since Kosovo became an international protectorate in 1999, the community's survival hangs by a thread; its sole guarantors are the Italian troops who patrol the unruly region in armoured cars. Take that guard away, and this medieval fortress would almost certainly suffer the fate of the 35 religious buildings that were damaged or wrecked by mobs during the two days of rioting, against Serbs and other non-Albanians, which shook the province last year.

So Decani's Father Sava Janjic, an internet-dextrous cleric known as the cyber-monk, is one of the many people who are watching nervously as the western powers that oversee Kosovo prepare for talks on the future of the province. The emotional stakes in Kosovo's bid for independence—massively backed by the ethnic Albanian majority—rose this week after the Kosovars' veteran leader, Ibrahim Rugova, said he had lung cancer.

“Whatever is decided about Kosovo's status, there will be a need for an international security force to guard places like this,” says Father Sava. He suggests that the care of Decani and other historic sites in Kosovo might be entrusted to an international body like the Council of Europe. “Above all, we don't want to be used by any side to stake out territory,” he insists.

Avoiding that danger—the use of holy sites and symbols to justify territorial claims—will be easier said than done. In several parts of the southern Balkans, religion, politics and diplomacy have recently become entangled in a messy way.

In Macedonia, a notionally religious dispute (pitting one Slavic Orthodox church against another) has led to a straining of ties with Serbia, with bizarre results. For example, a Serbian minister says he has held back two passenger aircraft which Serbia rents out to the Macedonian national airline—in part, at least, because of the general downturn in relations. The dispute has come to a head following the jailing in Skopje of a bishop, Jovan Vraniskovski—who is either (depending on your viewpoint) a pro-Serbian troublemaker who has sold out the Macedonian cause, or the only Orthodox prelate in the land whose office is valid in the eyes of the rest of the eastern Christian world.

How can a country that aspires to join the European Union go locking up clerics? In church matters, as in regional politics, Macedonia's Slavic majority feels it has struggled hard (and so far, unsuccessfully) to gain due recognition from its Balkan neighbours—each of which rests its position on passionately held views of history. And to cut a long, Byzantine story short, Macedonia's Orthodox church has been out of step with the rest of eastern Christendom since 1967, when (as part of communist Yugoslavia's political intrigues) it broke free from its Serb overlords.

Under Orthodox procedures, a national church usually gains independence by negotiation with its erstwhile masters. Bishop Jovan's camp says it is not against Macedonian self-government—but it must be negotiated, not asserted unilaterally. The first step should be reconciliation with Serbia. But to many people in Skopje (including those with zero interest in religion) this stance means betrayal of a country that is fighting an unequal battle to win the world's respect. “People feel their national identity is under attack,” says Ana Petruseva of the Balkans Investigative Reporting Network, a news service.

That is the background to the authorities' egregious treatment of Bishop Jovan. On July 27th, he was sentenced to at least 18 months in jail for “instigating national and religious hatred”. His dastardly crimes include printing calendars that reflect his view of church affairs, under which his authority is legitimate and that of his critics is not. The Supreme Court in Skopje may yet release him; but Bishop Jovan also faces separate charges of embezzling funds.

Meanwhile his opponents feel they are the victims. “It is not Jovan we are up against, but greater Serbian chauvinism,” laments Bishop Naum, a leading figure in the Macedonian church, reflecting the common view that the whole affair is a product of tricks hatched in Belgrade. His suspicions do not end there. He reckons that by meddling in Macedonian church politics, Serbia's authorities—both political and religious—are gearing up for a bigger contest in Montenegro, where a vote on independence may be held next year.

Bishop Naum may be exaggerating the tension in Montenegro, but his suspicions are not wholly absurd. As the “state union” between Serbia and Montenegro gets looser, the Serbian Orthodox church, and the federal army, are among the few agencies that straddle the two entities; and they co-operate. In July, the army sent helicopters to erect a small Orthodox church on Montenegro's Mount Rumija. To backers of independence, this act seemed like a provocation, organised from Belgrade.

Father Velibor Dzomic, a Serbian Orthodox priest in Podgorica, the Montenegrin capital, disagrees: he says all his church wants is equality under the law—and protection from a new Montenegrin Orthodox church that challenges its status.

Even as they proclaim their love of Serbia, some priests in Montenegro give the impression that

they are hedging their political bets and preparing for the day when Montenegro's ties with Belgrade are broken. Could this be so? “Our first concern”, insists Father Velibor, “is the kingdom of heaven.” If only that were always true.

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Charlemagne

Crisis, what crisis?

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From The Economist print edition

In praise of the prosaic

IN THE run-up to the French and Dutch referendums, supporters of the European Union constitution avoided the subtle approach. One commissioner went to a Holocaust memorial to hint at what might happen if the constitution were rejected; other “yes” campaigners showed footage of the killings at Srebrenica. It was a crisis, lamented Jean-Claude Juncker of Luxembourg, who then held the EU's revolving presidency, when the constitution went down in flames. After a bad-tempered summit a few weeks later, he upgraded his diagnosis to “deep crisis”.

Three months on, as European officials and politicians saunter back from holiday, one might be forgiven for asking: what crisis? War has not broken out in the Balkans. Italy has not pulled out of the euro. The work of EU institutions grinds on as if nothing had happened. Bloated farm payments are being scattered far and wide. The trade commissioner has wangled his way out of another row with China. The European Commission has announced it will accept the position taken by the Council of Ministers on batteries (phew!). Just another day at the office.

This is not to say that nothing at all actually happened. Obviously, voters blew their representatives a magnificent raspberry. But it was not quite the disaster that some had foretold. The rejection by two founding members of the Union has almost certainly ended not only the constitution (which needed to be ratified by all to come into force), but also the entire drive towards ever deeper European integration. For decades, this has proceeded through a succession of treaties, most of which handed over more power from national to European institutions. Now, and for the foreseeable future, new treaties will have to be put to voters—who are now minded to vote almost everything down. The goal of “ever closer union” sounds about as inevitable, these days, as the dictatorship of the proletariat.

European bigwigs are starting to recognise this. Immediately after the referendum, they were in denial. One government after another insisted ratification would continue. Austria's chancellor even said that France and the Netherlands would have to vote again until they got it right. Some people still think like this (the leader of the largest party in the European Parliament has just opined that the time was ripe for the French and Dutch to have another go). But on a trip to Poland to celebrate the 25th anniversary of Solidarity, the president of the European Commission, José Manuel Barroso, admitted openly: “In the foreseeable future, we will not have a constitution. That's obvious. I haven't come across any magic formulae that would bring it back to life.” That recognition of reality is spreading.

What they have not yet accepted is that the defeat of the constitution may be no bad thing, and that living with its consequences may be the most sensible approach. This conclusion may take a while to sink in—not just because people are awaiting the German election before doing anything at all, but because there are several plausible-sounding (but in fact, unjustified) reasons for worrying about the fall-out from the referendums.

They boil down to this: the rejection of the constitution has damaged a lot of the best things about

the EU. It may bring the next round of enlargement to a halt—and enlargement has been one of the EU's successes. It may set back the prospects of economic reform—again, one of the EU's more important (if hardly popular or successful) tasks. It will certainly stop in their tracks efforts to make running the EU less cumbersome.

But enlargement was a problem even before the referendums. Croatia missed its deadline for starting entry negotiations in March, before the referendum campaigns began. Turkey, the biggest country waiting outside the entrance, was always going to be a mouthful, regardless of the referendum—though the French government's promise to put the Turks' admission to a popular vote has further dimmed their prospects.

Antipathy to the dreaded “Anglo-Saxon” model of capitalism clearly played a part in the constitution's defeat. European voters want to keep the cruel world at bay. But Angela Merkel's probable victory in Germany, the rise of Nicolas Sarkozy in France, and the imperative of demographic decline are all likely to keep economic reform on the EU's agenda, however much voters want to avoid it. As for the bureaucratic reforms buried by the constitution's defeat, they are a loss (it is hard to run a club of 25 with machinery made for 12, or even for six). Still, this is the least of the reasons for fretting about the constitution, and it may yet be possible to make some minor institutional improvements in any case.

The right response

In short, there are few reasons for seeing the defeat of the constitution as a disaster in itself. Hence the EU's reluctance to collapse during the summer. The corollary is that the proper response would be to go back to what the EU was trying to do before: that is, improve the single market, enlarge the club where it can, undertake the economic reforms its members promised at Lisbon in 2000, but have mostly failed to achieve.

The trouble with this prescription is that it is prosaic—and prose quickens few European hearts. In “Le Bourgeois Gentilhomme”, Molière's Monsieur Jourdain was excited to discover that he had been speaking prose all his life—but he is, characteristically, a figure of derision. Instead, Europeans thrill to visionary talk of “solidarity”, of “a European social space” and to grand, imprecise goals. “We're not here just to make a single market, that doesn't interest me,” said a former European Commission president, Jacques Delors, “but to make a political union.”

The impulse (if not the final ambition) persists. But the rejection of the constitution has weakened it. The past few weeks have shown the EU can work perfectly well without the vision thing. Can its leaders accept that a certain unaccustomed modesty might be not just advisable, but desirable?

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Flat income tax

A dip in the middle

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The Conservatives toy with a politically risky idea

INCOME tax has been paid in Britain for more than two centuries. First introduced by William Pitt the Younger to finance the war against Napoleonic France, it is the Treasury's biggest source of revenue, raising 30% of tax receipts. It arouses strong political emotions, regarded as fair by some because it makes the rich pay a bigger share of their income than the poor, but unfair by others because it penalises enterprise and hard work.

During the past 30 years, income tax has been subject to sweeping changes, notably the cut in the top rate from 98% to 40% under Margaret Thatcher between 1979 and 1988. Now another Conservative politician, George Osborne, is floating a radical reform to match that earlier exploit. The shadow chancellor announced on September 7th that he was setting up a commission to explore the possible introduction of a flat tax in Britain.

Mr Osborne's big new idea stems in part from frustration at the Conservative party's failure to win votes on tax in the past two elections. Their proposal to cut taxes by £4 billion ($7.4 billion) a year did them few favours at the polls in May. Such a paltry reduction in a trillion-pound economy seemed an apology of a policy.

By contrast, the introduction of a flat tax would be a radical step. The reform is already being tried elsewhere. Mr Osborne first expressed interest in the flat tax after a visit in June to Estonia, which introduced it in 1994. Since then eight other countries in eastern and central Europe have followed suit. Poland appears likely to adopt a flat income tax. Even Germany is flirting with the idea (see article).

Introducing a flat income tax into Britain would involve two main changes. At present, there are three marginal tax rates. The first £2,090 of taxable income is taxed at 10%; the next £30,310 is taxed at the basic rate of 22%; and income above that is taxed at the higher rate of 40%. These three rates would be replaced by a single rate, which would be considerably lower than the current top rate. At the same time there would be an increase in the tax-free personal allowance, currently worth £4,895.

Flat-tax proponents say that the reform would yield many economic benefits. If it were combined with an assault on other tax reliefs, then it would simplify a tax system that is groaning with complexity. The latest edition of “Tolley's Yellow Tax Handbook”, which contains all direct-tax legislation for 2005-06, runs to four weighty volumes and has roughly doubled in length since Gordon Brown became chancellor of the exchequer in 1997. Only this week, Mr Brown was upbraided by a parliamentary committee for the complex “nightmare” of his system of tax credits, designed to help poorer families.

Another advantage is that reform could sweep a lot of low-paid people out of income tax altogether. In the past eight years under Labour, the number of income-tax payers has risen from 26.2m to 30.5m. Over the same period, the number of higher-rate taxpayers has risen from 2.1m

to 3.6m.

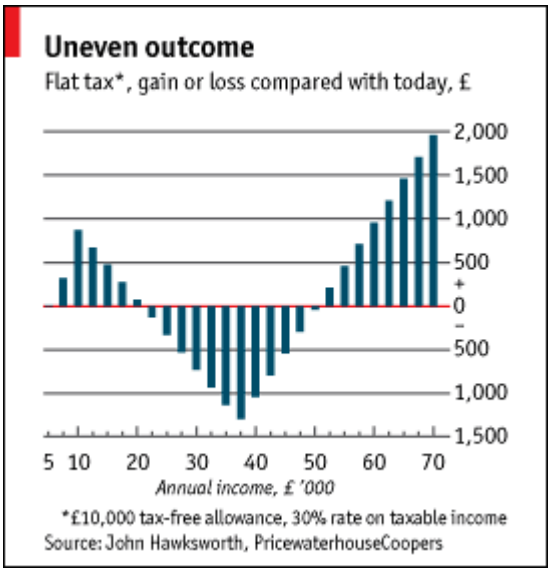
Flat-tax fans also think that it could trigger a new economic dynamism, as people respond to the enhanced incentive to work harder. The more this happens, the more the reform could pay for itself as a bigger economy generates more tax revenues.

So much for the economic case for a flat tax. What of its politics? One obvious objection is that the reform would be unfair, since the richer would pay less tax than they do at present. Advocates of a flat tax make two rejoinders. First, an income-tax system with a single rate remains progressive—the rich pay a higher proportion of their income than the poor—as long as it is combined with a tax-free allowance. Second, the rich can exploit current complexities to avoid taxes in ways that could be curtailed in a flat-tax system.

But could a flat tax be introduced without there being losers? A recent paper from the Adam Smith Institute suggested that this would indeed be possible. Richard Teather, its author, proposed a flat-rate tax of 22%, the present basic rate, with a tax-free personal allowance of £12,000, more than double the current one. “All taxpayers would be better off under the reform,” he argued.

However, the proposal has an obvious flaw. As Mr Teather himself admits, it would result in an initial loss in revenue of £50 billion a year. That is over a third of the total income-tax receipts of £138 billion that the Treasury expects this year; and a tenth of all government revenues.

Unless public spending were slashed, other taxes would have to rise to meet this shortfall. So a more realistic simulation of the impact of a flat tax is to make it revenue-neutral. *The Economist* asked John Hawksworth, an economist at PricewaterhouseCoopers, an accountancy firm, to calculate what that might involve. He said the current yield of income tax could be preserved with a flat rate of 30% and a personal allowance of £10,000. We also asked Mr Hawksworth to estimate what impact such a reform would have on income-tax payers. Under this revenue-neutral approach, there would be losers as well as winners compared with current tax bills (see chart).



Those who would gain are low-earners as well as high-fliers. For example, someone on £10,000 would gain 8.7% of their income; someone on £100,000 would gain 5% of their income. Those who would lose are in the middle, with losses peaking at 3.5% of income at the current higher-rate threshold of £37,295. In all, more than 10m income-tax payers—a third of the present number—would lose from such a reform.

Clearly, different combinations of allowance and tax rate would generate different results. But the general pattern would remain the same. “If you raise the same revenue but increase the allowance, then it is the people in the middle of the income tax paying population that lose from a flat tax,” says Christopher Heady, head of tax policy at the OECD.

This finding is politically awkward for the Tories. Unless a flat income tax were financed by big increases in other taxes, it is difficult to see how it could realistically be introduced without exacting a lot of pain among middling earners. Yet their votes will be crucial if the Conservatives are to stand any chance at the next election.

The flat tax is an arresting idea—and politically attractive because it gives the Tories a platform to attack Labour's itch to meddle with the tax code—but it does not get the Conservatives off the hook. Mr Osborne wants lower and simpler taxes. However, he will be able to achieve that goal only if he can work out a convincing set of proposals to cut public spending.

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The newspaper business

Paper tigers

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From The Economist print edition

Newspapers are trying all sorts of strategies to slow their decline

PERHAPS British newspapers are being spurned by younger readers, but nobody can accuse them of resigning themselves to their fate. The *Guardian* will relaunch itself on Monday in a "Berliner" format, smaller than broadsheet and slightly bigger than tabloid. Having changed its shape from broadsheet to tabloid last year, the *Times* on Monday put its price up by five pence to 60 pence ($1.10). And a more radical response appeared with the launch of *City A.M.*, a new free daily paper aimed at business readers.

On the surface, the *Times's* price rise looks like a sign of confidence: the paper has invested in its journalism, says Les Hinton, executive chairman of News International, and it now believes it can raise its price with little effect on circulation. But the price rise signals an end to an era when Rupert Murdoch was so bullish about newspapers that he was prepared to leave millions on the table in return for capturing market share. After he cut the price of the *Times* to 30 pence in 1993, he doubled its circulation, mostly at the expense of the *Independent* and the *Telegraph.*

"Quality" dailies have lost so many readers since then that the ones who remain may not be particularly price-sensitive. It may be, also, that Mr Murdoch is tired of losing money on newspapers. A five pence hike will not stop the *Times* making losses, says an insider, but it is a "significant step towards profitability".

Although fewer people are buying papers, lots more are reading free ones. Earlier this year Mr Murdoch blamed *Metro*, a free daily general newspaper owned by Associated Newspapers, publisher of the paid-for *Daily Mail*, for taking sales away from the *Sun*. On the other hand, some newspaper consultants reckon, if young people are reading freesheets, it might just entice the next generation into buying the real thing later on.

Most free papers are generalist, and it is far harder for a business and finance freesheet to get any attention from professionals. Jens Torpe, *City A.M.'s* chief executive, says he intends the new paper to pick up readers that the *Financial Times* (which belongs to Pearson, part-owner of *The Economist*) has lost by becoming too much of a generalist broadsheet and not concentrating enough on business and finance. So far, however, *City A.M*. is a long way off the depth and seriousness of business and finance coverage offered by any quality paid-for paper, let alone the *FT*.

Metro International, a Swedish company that has launched free newspapers around the world, has been considering launching a free business paper for the City for some months, according to somebody who knows the company's thinking. Mr Torpe used to work for Metro International, and his old employer is evaluating whether to try to bypass *City A.M.* with a higher-quality rival.

Attracting younger readers is the main reason for the *Guardian's* change to a "Berliner" format, with colour throughout. Young and especially female readers are put off by the unwieldiness of broadsheets, and both the *Times* and the *Independent* have seen a bounce in circulation since

turning tabloid. Going all the way, however, says Carolyn McCall, chief executive of Guardian Newspapers, would have meant dumbing down the front page by including fewer headlines.

The new format will cost the *Guardian* more than £80m in new printing presses and marketing. It will take a sizeable jump in circulation for the investment to be judged a success. Nonetheless, this week's burst of activity shows that while Britain's newspaper market is not thriving, it is still vibrant and innovative.

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Economist.com WORLD EUROPE

Segregation

Ghettos of the mind

Sep 8th 2005 | BRADFORD
From The Economist print edition

Britain's Muslims have a reputation for self-segregation. That is unfair

Get article background

DEEP poverty lurks inside the back-to-back terraced houses of Manningham. More than a third of households lack central heating or the sole use of a bath and indoor toilet, and 57% have no car. The neighbourhood is homogenous: seven out of ten residents are Pakistani or Bangladeshi Muslims, and even those groups live in different streets. The police are viewed with suspicion and hostility, as riots in 1995 and 2001 showed. It is the sort of area that British politicians have in mind when they warn about the dangers of unchecked immigration and multiculturalism.

The view from Manningham is more complex. Local people cite the neighbourhood's many advantages—the strong sense of community, the convenience of living close to the mosque, the lack of white racism and (so it is claimed, even by a self-confessed car thief) the lack of crime. But pride is mixed with widespread worry that the area is becoming a ghetto.

Ayyaz Aslam, who works for a local personal-injury firm, regrets the absence of whites. He is even discomfited by the closure of pubs, even though they meant nothing but trouble for Muslims. Mr Aslam firmly rejects the suggestion, expressed in two reports into the 2001 riots and, increasingly, by politicians, that Muslims are deliberately isolating themselves in areas like Manningham. “It's not a matter of wanting to be separate. We want to keep our identity, but we don't insist on living apart from everybody else.”

Muslims from the Mirpur region of Pakistan came to Bradford in the 1950s and 1960s to work in the town's now-defunct textile mills. They were poor, rural and often illiterate in Urdu, let alone English. Their long-term prospects were dim: economists who study the fortunes of immigrants say that education and knowledge of English are the predictors of success. Nor did the immigrants' narrow background help them fit in socially. As Mohammed Ajeeb, a former Lord Mayor of Bradford, says, “if the same people had moved to Karachi, they would not have integrated well, either.”

Whether Bradford and other northern English towns have become more ghettoised over time is a controversial matter. Geographers have disagreed so vehemently, for so long, that they refer to the debate as the “index wars”. One camp uses an index of isolation, which measures the likelihood that two inhabitants of an area will belong to the same ethnic group, to prove the existence of ghettos in Bradford, Leicester and Oldham. Mike Poulsen of Macquarie University, in Australia, told a London conference last week that Bradford's Pakistanis are now as isolated as African-Americans in New York. Worse still, the trend is towards ghettoisation.

The other camp favours the index of segregation, which measures how the members of an ethnic group are distributed. By that measure, Bradford is becoming less segregated, along with England and Wales as a whole. In 1991, according to Ceri Peach, an Oxford University geographer, 60% of Pakistanis and 70% of Bangladeshis would have to move in order to spread themselves evenly

across the city's wards. By 2001, those proportions had fallen to 51% and 60%. Afro-Caribbeans and Indians were less segregated, as they are in most British cities.

Oddly, both views are right: Bradford's Muslims are both more ghettoised and more integrated. Thanks to high birth rates and immigration, particularly of spouses and relatives, the ethnic Pakistani and Bangladeshi population of Bradford swelled from about 36,000 to 73,000 between 1981 and 2001. Many of the newcomers settled in traditionally Asian areas like Manningham; as a result, the ghetto has grown.

At the same time, though, the more successful Muslims have moved into mostly white areas. In Heaton Village, a neighbourhood of detached and semi-detached houses north-west of Manningham, the number of Pakistanis trebled between 1991 and 2001. When Mr Ajeeb moved to Heaton, in 1986, he was met with disbelieving looks. Now he is trying to sell his expensive (for Bradford) house, and finds that every potential buyer is Pakistani.

If the tide of South-East Asian migrants had broken upon Bradford in a single wave, as did the Kenyan and Ugandan Asians who fled to London and the Midlands in the late 1960s and early 1970s, their story would be simpler, and happier. The immigrants and their descendants would be noticeably more integrated. They would probably be more successful, too: the arrival of more unskilled hands has harmed the group's economic profile.

Immigration and population growth have obscured the progress of some Pakistanis and Bangladeshis and made them vulnerable to accusations that they do not wish to live among whites. That is unfortunate at a time when Muslims have become associated with extremism. The new arrivals have some advantages, though: they have pushed up the price of housing, helping the better-off to escape the ghetto.

Two changes may lead to an improvement in the reputation of Bradford's Asians. The first is that the government, harried by the Conservative Party and by opinion polls that reveal opposition to immigration, is legislating to restrict the flow of unskilled labourers and to end the practice of “chain migration”, through which relatives can gain entry to Britain. The second change, which is no more popular than the first, is the recent arrival of immigrants of different hues. Many are asylum-seekers, who are even less popular than Asian Muslims and provide a new focus for resentment. In Manningham, there is excited discussion about another group, who are said to live ten to a house in conditions of squalor. They are the Poles.

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Education

Age of reason

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British schools group students strictly by age. That may be changing

Get article background

FROM October 2006, British employers will be expected not to make decisions about recruitment, training, promotion and dismissal on the basis of age, unless they can justify them objectively. And quite right, too, you may say, especially if you are being “encouraged” to retire early to save your company money, or are hoping to be promoted ahead of older, less able colleagues.

But the legislation will have no effect in schools—perhaps the country's most ageist institutions. In England and Wales, students enter, progress through and exit the school system almost entirely according to the date on their birth certificates. (The Scottish system is slightly more flexible about the age at which children start.)

Whether students are grouped rigidly by age differs widely from country to country. In some places, many children start school late or repeat a year; in others this is rare.

The countries where it is rare tend to be those where educational outcomes are comparatively even, such as Finland and the other Nordic countries; it is more common in countries where outcomes are less equal, in particular, America. More than 20% of students in many American states repeat at least a year of schooling. Britain is an anomaly, with educational outcomes varying widely according to parental income and social class—but strict adherence to schooling by age.

Now one school, Bridgemary Community School in Hampshire, has decided to throw the calendar out, and from this autumn is grouping students by ability alone. The head teacher describes the new policy using buzzwords a management consultant could be proud of: 24/7 learning community, vertical learning-groups, dominant learning styles, a shopping-basket curriculum. Although the language is flowery, the vision is simple: students should learn as much as they are capable of, just as soon as they are ready.

A change this autumn in the way the government draws up school league tables will facilitate changes in the rest of the system, too. In the past, primary schools had been discouraged from holding students back a year by secondary schools, which used to be able to count only the GCSE results of students who were under 16 when they took the exams. Some secondary schools had been threatening that students who were older than they “should” be would have to skip a year so as to take their GCSEs on time.

Although holding children back if they are perceived to be immature is common practice in many countries, it is frowned on by many education researchers. It's not children who need to be ready for school, they argue, but schools that need to be ready to educate children in all their glorious variety.

The trouble is that variety can be hard to cope with. In a comparison of mathematical attainment between Switzerland and Britain, Professor Sig Prais of the National Institute for Economic and Social Research found that the Swiss practice of holding back some later developers during primary school resulted in school classes that were more homogeneous than those in Britain. This meant that whole-class teaching was easier, helping students to progress at a faster rate.

There are other reasons to think that some children who are young for their year group might do better if they were held down a class. Such children are more likely to suffer from psychiatric disorders and to have special educational needs, and less likely to complete school, do well in exams or go to university.

The effect is small at the individual level, but because so many children are involved, the implications are large. In a 2003 study, researchers at the Institute of Psychiatry and Imperial College London estimated that if all children suffered mental illness at the same rate as the oldest in each year group, there would be 60,000 fewer mentally ill children aged between 5 and 15 in Britain. They recommended adopting a more flexible approach to children's progression through school.

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Fuel prices

Inflammable

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The effects of high fuel prices

TWO things are dominating talk at British dinner tables: the happy possibility of beating Australia at cricket and news about fuel prices. In the wake of Hurricane Katrina these have hit 95p a litre for petrol and 98p for diesel—more in real terms than in 2000, when angry farmers and lorry drivers blockaded refineries and brought Britain to a standstill. This week the protesters promised a repeat performance unless ministers cut fuel taxes by Wednesday.

Yet circumstances now are very different from five years ago. Then, high prices followed the government's policy of above-inflation tax rises, inherited from the Tories. That annoyed hauliers by making it hard for them to compete with their European rivals, who paid lower taxes. But the government has learnt its lesson: since the protests, fuel duty has been frozen in every budget but one. Dear oil is the reason for today's pricey petrol, and the global oil market is beyond the government's control.

So while British hauliers are watching their fuel bills soar, so are their European counterparts. Nor does the public seem ready to kick up a fuss: “We've not had anyone phoning in to complain about prices,” says the AA, a drivers' organisation. “We certainly did in 2000.”

Still, high prices are having an effect on the economy. Jonathan Loynes of Capital Economics, a consultancy, reckons that oil price rises have added around 0.4 percentage points to inflation. That hit 2.3% in July, up from 1.4% the year before and above the Bank of England's target of 2%. Raw materials are squeezing profits. And if petrol stays high, consumer spending could suffer.

A few organisations have cause to cheer. Oil-company profits should benefit. And even if Gordon Brown, the chancellor, postpones a planned rise in fuel duty later this year, the Institute for Fiscal Studies, a think-tank, reckons that extra taxes from those profits ought more than to make up for the lost revenue.

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The Tory leadership

The constituencies' constituency

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Proposed changes in the leadership election rules have hit trouble

Get article background

IT'S beginning to look like another fine Tory mess. When Michael Howard announced his decision to quit in the immediate aftermath of May's election, one of the reasons he gave for launching a protracted leadership contest was the need to change the voting rules before his successor could be chosen. He was determined to avoid a repetition of the circumstances that had blighted the prospects of his hapless predecessor, Iain Duncan Smith.

Under rules established by another short-lived leader, William Hague, the 300,000 or so members of what Tories call the “voluntary party” were allowed to choose between the two candidates who had made it through to the final round of voting by MPs. Thanks to his stridently anti-European views, Mr Duncan Smith won the backing of the party's activists over the vastly better-qualified Ken Clarke in 2001. But, without the support of Tory MPs, of whom little more than a third had voted for him, even a much smarter operator than Mr Duncan Smith would have struggled to establish his authority in Westminster. The simple answer to the problem—and the one supported by a large majority of MPs—was to return to the old way of picking a leader, in which MPs alone made the choice.

Until recently, it looked as if the party hierarchy would get its way. A couple of weeks ago, ballot papers on the rule change were duly sent out to the 1,133 members of the party's “constitutional college” in the expectation that the right result—the necessary two-thirds majority—would be delivered in good time for the party conference on September 27th.

That now looks much less certain. Although most of the activists are also keen to avoid foisting an unpopular leader on the parliamentary party, they are less than happy at being deprived of any say at all.

Last weekend, Francis Maude, the party chairman, and Mr Howard, sensing that rebellion was in the air, warned activists of the perils of rejecting the rule change. Mr Howard pleaded: “For the sake of our party and...our country, I hope that when it comes to the vote, the proposed changes win your support.” However, a straw poll of constituency chairman conducted by a Sunday newspaper discovered that 44% were planning to vote in defiance of Mr Howard and that 36% were unhappy at their treatment. Mr Maude says he hasn't a clue what the outcome will be, but it is likely to be close.

For the leadership contenders, it's a ticklish situation. If the party members keep their vote, woe betide the candidate who favoured their disenfranchisement. Yet none of them would want to find themselves in the same untenable position as Mr Duncan Smith. Some also feel uncomfortable about supporting a system that would in effect exclude from the leadership vote the regions and cities of Britain that no longer return a Tory MP.

Nearly everybody now says that they would like to see an electoral college that would leave MPs with greatest say, but would include other elements in the party. Unfortunately, such a compromise is too late for this contest. If the vote goes against change, a new leader will not be in place until mid-January at the earliest. How nice for the government.

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Corporate killing

Killing on the job

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A controversial court case re-opens the debate on corporate killing

THIS week a judge at the Old Bailey convicted Network Rail, the company that owns Britain's railway infrastructure, of breaching health and safety laws over the Hatfield rail crash in 2000, when a faulty rail led to four deaths. Balfour Beatty, the engineering firm maintaining the track, had already pleaded guilty. The lesser verdict was the only sanction available after July, when the judge had thrown out more serious charges of corporate manslaughter levelled at three of Network Rail's former employees and two of Balfour Beatty's.

Campaigners seized on the outcome as further proof that the laws that govern corporate killing need reform. The Law Commission, charged with reviewing Britain's laws, first suggested this in 1996. Nine years, one consultation paper and two manifesto pledges later, the government has published a draft bill. Few doubt that change is necessary: today's rules—which require the prosecution to prove that a single “controlling mind” is to blame for a death—make it hard enough to convict small firms and virtually impossible to convict big ones, where responsibility is spread among managers. That's unfair, which is why the government (egged on by victims' families and trades unions) plans to allow “senior management failures” to be blamed instead.

But harmony on the desirability of reform has been marred by disagreement over details. The unions wanted beefier penalties, with fines and jail terms for guilty directors. Business groups argued this would force companies to take out expensive insurance and would make managers timid. Business won that battle: no such plans are in the final bill, although the government has asked the Health and Safety Commission to look at them again.

Another question was over exemptions for certain public bodies. Cynics suspect ministers panicked when they realised that they might be charged under the laws. A compromise was reached which exempted government departments over policy or “core public functions”, but not their ordinary behaviour as employers.

Despite all the discussion, the bill remains complicated. “Who is a senior manager? Did they owe a duty of care to the deceased? Were they really grossly negligent? In practice, this bill is extremely complex,” says Andrew Litchfield, a health and safety lawyer with Wragge and Co. “It will make for some very happy lawyers.”

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Bagehot

Reasons not to be cheerful

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So far, there's nothing to suggest that the Tory leadership contest will make the party stronger

Get article background

THE interminable contest for the Conservative leadership has at last begun to take shape. Unfortunately, for those impatient for a revival of Tory fortunes, the signs are not encouraging.

There are four candidates of whom it could be said they are “serious” in that they all have a base of support and some chance, however unlikely, of success. There is a fifth, David Willetts, who is the most serious of them all intellectually, but who, alas, is widely presumed to be too wonkish for the top job.

Of the serious contenders, they break down easily in terms of age and political orientation. Two are fighting from the party's left of centre—David Cameron and Ken Clarke. The other two, David Davis and Liam Fox, belong to the right of centre from which (with the accidental exception of John Major) the party has drawn its leaders for the past 30 years. Mr Davis and Mr Clarke (especially Mr Clarke), claim to have the necessary weight and experience to biff the government effectively. The other two boast that they have the youth and freshness needed for what may well be an eight-year grind in opposition.

A number of other things have also become clearer since MPs began returning to Westminster from their summer holidays—and they should not be of much comfort to any of the contenders. The first is that although Mr Davis is undoubtedly still the front-runner with between 50 and 60 MPs (out of 198) committed to him, his momentum appears, at least for now, to have stalled. That may not mean anything: it is probably true that a good many MPs will not make up their minds until after the party conference and it is also quite likely that Mr Davis, who is a canny operator, is keeping a few high-profile supporters up his sleeve to be revealed one at a time in the weeks ahead.

More worrying for the Davis camp is the possibility that their man is finding it difficult to dispel some of the reservations people continue to have about him, above all, his single-minded personal ambition and reputation for disloyalty. They will have been reminded of both by Mr Davis's attack this week on Michael Howard's attempts to change the leadership voting rules.

The second is that if Mr Davis fails to overcome the prejudices against him, the direct beneficiary is most likely to be Dr Fox, who shares with Mr Davis the conviction that what the Tories most need is to rediscover their ideological self-confidence, but is jollier and less menacing.

Both Mr Davis and Dr Fox take their inspiration from Margaret Thatcher's leadership campaign in 1975. But those were very different times: Tory corporatism had failed, a divided Labour government was clinging to office with a tiny majority, middle-class incomes and values were under unprecedented attack and the economy was locked into relative decline and stagflation.

The third thing to have emerged this week is the scale of Mr Cameron's task in trying to turn himself from a backroom boy with only four years as an MP into a plausible leadership candidate. That he has made a reasonable fist of it is thanks to the enthusiasm of a young, metropolitan group of MPs who have close connections with the newspaper commentariat—two of them, Michael Gove and Boris Johnson, are powerful journalists themselves. To make himself better known, Mr Cameron is giving a series of speeches setting out his political credo. It's a difficult thing to do. Although the speeches, which have emphasised the importance of family and community, have been all right, their well-meaning blandness is unlikely to have lit anyone's fire.

Mr Cameron would like to be seen as his party's answer to Tony Blair and, indeed, argues that the great opportunity for the Tories is to snatch the best bits of Mr Blair's legacy for themselves when he is succeeded by Gordon Brown. There would be much to be said for such a strategy once Mr Cameron was leader, but it is not helping him get there in the first place. To many Tories, he appears far too admiring of the enemy to suggest he would be a ruthlessly effective opposition leader, while the hinted claim to be “Tory Blair” is, at best, premature.

When Mr Blair became leader of his party he had been its outstanding frontbench and television performer for several years and was seen as an ardent moderniser who had displayed courage in taking on Labour's hidebound establishment. A MORI poll of voters' attitudes towards probable Labour leadership candidates taken immediately after John Smith's death gave Mr Blair 32% support (John Prescott had 19% and Gordon Brown just 9%). In a similar poll on the Tory contenders undertaken by Populus for the *Times* this week, Mr Cameron scored 2%.

If only he weren't so popular

Which brings us to the fourth development. In the same poll, Mr Clarke won the support of 41% of the general public—four times the score for Mr Davis. Equally telling was the finding that among Tory voters, Mr Clarke's lead over Mr Davis was 55% to 16%. Yet the evidence of Mr Clarke's popularity with the public seems to impress Westminster Tories hardly at all. Although his past Europhilia still counts against him, despite his partial recantation, the most common complaint about Mr Clarke is his failure to slog away on behalf of the party during the past eight years. While many of his former admirers have left Westminster since the last leadership election, Mr Clarke, either through laziness or arrogance, has done almost nothing to woo the two most recent intakes of MPs, who represent getting on for 40% of the current Parliamentary party.

Myopic Tory MPs explain away Mr Clarke's poll ratings as due to nothing more than name recognition and the loud splash of publicity when he plunged into the race last week. Mr Clarke does have his faults. But if more polls show he is overwhelmingly the Tories' most potent electoral asset, the voters will reach their own conclusion about a party that continues to reject him largely because it is in the grip of a collective hissy fit.

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The brains business

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Alamy

Mass higher education is forcing universities to become more diverse, more global and much more competitive, says Adrian Wooldridge

FOR those of a certain age and educational background, it is hard to think of higher education without thinking of ancient institutions. Some universities are of a venerable age—the University of Bologna was founded in 1088, the University of Oxford in 1096—and many of them have a strong sense of tradition. The truly old ones make the most of their pedigrees, and those of a more recent vintage work hard to create an aura of antiquity.

And yet these tradition-loving (or -creating) institutions are currently enduring a thunderstorm of changes so fundamental that some say the very idea of the university is being challenged. Universities are experimenting with new ways of funding (most notably through student fees), forging partnerships with private companies and engaging in mergers and acquisitions. Such changes are tugging at the ivy's roots.

This is happening for four reasons. The first is the democratisation of higher education—"massification", in the language of the educational profession. In the rich world, massification has been going on for some time. The proportion of adults with higher educational qualifications in the OECD countries almost doubled between 1975 and 2000, from 22% to 41%. But most of the rich countries are still struggling to digest this huge growth in numbers. And now massification is spreading to the developing world. China doubled its student population in the late 1990s, and India is trying to follow suit.

The second reason is the rise of the knowledge economy. The world is in the grips of a "soft revolution" in which knowledge is replacing physical resources as the main driver of economic growth. The OECD calculates that between 1985 and 1997 the contribution of knowledge-based industries to total value added increased from 51% to 59% in Germany and from 45% to 51% in

Britain. The best companies are now devoting at least a third of their investment to knowledge-intensive intangibles such as R&D, licensing and marketing. Universities are among the most important engines of the knowledge economy. Not only do they produce the brain workers who man it, they also provide much of its backbone, from laboratories to libraries to computer networks.

The third factor is globalisation. The death of distance is transforming academia just as radically as it is transforming business. The number of people from OECD countries studying abroad has doubled over the past 20 years, to 1.9m; universities are opening campuses all around the world; and a growing number of countries are trying to turn higher education into an export industry.

The fourth is competition. Traditional universities are being forced to compete for students and research grants, and private companies are trying to break into a sector which they regard as “the new health care”. The World Bank calculates that global spending on higher education amounts to $300 billion a year, or 1% of global economic output. There are more than 80m students worldwide, and 3.5m people are employed to teach them or look after them.

Enemies of promise

All this sounds as though a golden age for universities has arrived. But inside academia, particularly in Europe, it does not feel like it. Academics complain about “the decline of the donnish dominion” (the title of a book by A.H. Halsey, a sociologist), and administrators are locked in bad-tempered exchanges with the politicians who fund them. What has gone wrong?

The biggest problem is the role of the state. If more and more governments are embracing massification, few of them are willing to draw the appropriate conclusion from their enthusiasm: that they should either provide the requisite funds (as the Scandinavian countries do) or allow universities to charge realistic fees. Many governments have tried to square the circle through tighter management, but management cannot make up for lack of resources.

So in all too much of the academic world, the writer Kingsley Amis's famous dictum that more means worse is coming to pass. Academic salaries are declining when measured against similar jobs elsewhere, and buildings and libraries are deteriorating. In mega-institutions such as the University of Rome (180,000 students), the National University of Mexico (200,000-plus), and Turkey's Anadolu University (530,000), individual attention to students is bound to take a back seat.

The innate conservatism of the academic profession does not help. The modern university was born in a very different world from the current one, a world where only a tiny minority of the population went into higher education, yet many academics have been reluctant to make any allowances for massification. Italian universities, for instance, still insist that all students undergo a *viva voce* examination by a full professor, lasting an average of about five minutes.

What, if anything, can be done? Techno-utopians believe that higher education is ripe for revolution. The university, they say, is a hopelessly antiquated institution, wedded to outdated practices such as tenure and lectures, and incapable of serving a new world of mass audiences and just-in-time information. “Thirty years from now the big university campuses will be relics,” says Peter Drucker, a veteran management guru. “I consider the American research university of the past 40 years to be a failure.” Fortunately, in his view, help is on the way in the form of internet tuition and for-profit universities.

Cultural conservatives, on the other hand, believe that the best way forward is backward. The two ruling principles of modern higher-education policy—democracy and utility—are “degradations of

the academic dogma", to borrow a phrase from the late Robert Nisbet, another sociologist. They think it is foolish to waste higher education on people who would rather study "Seinfeld" than Socrates, and disingenuous to confuse the pursuit of truth with the pursuit of profit.

The conservative argument falls at the first hurdle: practicality. Higher education is rapidly going the way of secondary education: it is becoming a universal aspiration. The techno-utopian position is superficially more attractive. The internet will surely influence teaching, and for-profit companies are bound to shake up a moribund marketplace. But there are limits.

A few years ago a report by Coopers & Lybrand crowed that online education could eliminate the two biggest costs from higher education: "The first is the need for bricks and mortar; traditional campuses are not necessary. The second is full-time faculty. [Online] learning involves only a small number of professors, but has the potential to reach a huge market of students." That is nonsense. The human touch is much more vital to higher education than is high technology. Education is not just about transmitting a body of facts, which the internet does pretty well. It is about learning to argue and reason, which is best done in a community of scholars.

This survey will argue that the most significant development in higher education is the emergence of a super-league of global universities. This is revolutionary in the sense that these institutions regard the whole world as their stage, but also evolutionary in that they are still wedded to the ideal of a community of scholars who combine teaching with research.

The problem for policymakers is how to create a system of higher education that balances the twin demands of excellence and mass access, that makes room for global elite universities while also catering for large numbers of average students, that exploits the opportunities provided by new technology while also recognising that education requires a human touch.

America rules 1

The world's top universities*

1	Harvard University	America
2	Stanford University	America
3	University of Cambridge	Britain
4	University of California *(Berkeley)*	America
5	Massachusetts Institute of Technology	America
6	California Institute of Technology	America
7	Princeton University	America
8	University of Oxford	Britain
9	Columbia University	America
10	University of Chicago	America
11	Yale University	America
12	Cornell University	America
13	University of California *(San Diego)*	America
14	Tokyo University	Japan
15	University of Pennsylvania	America
16	University of California *(Los Angeles)*	America
17	University of California *(San Francisco)*	America
18	University of Wisconsin *(Madison)*	America
19	University of Michigan *(Ann Arbor)*	America
20	University of Washington *(Seattle)*	America

*Ranked by a mixture of indicators of academic and research performance, including Nobel prizes and articles in respected publications

Source: Jiao Tong University, Shanghai

As it happens, we already possess a successful model of how to organise higher education: America's. That country has almost a monopoly on the world's best universities (see table 1), but also provides access to higher education for the bulk of those who deserve it. The success of American higher education is not just a result of money (though that helps); it is the result of organisation. American universities are much less dependent on the state than are their competitors abroad. They derive their income from a wide variety of sources, from fee-paying students to nostalgic alumni, from hard-headed businessmen to generous philanthropists. And they come in a wide variety of shapes and sizes, from Princeton and Yale to Kalamazoo community college.

This survey will offer two pieces of advice for countries that are trying to create successful higher-education systems, be they newcomers such as India and China or failed old hands such as Germany and Italy. First: diversify your sources of income. The bargain with the state has turned out to be a pact with the devil. Second: let a thousand academic flowers bloom. Universities, including for-profit ones, should have to compete for customers. A sophisticated economy needs a wide variety of universities pursuing a wide variety of missions. These two principles reinforce each other: the more that the state's role contracts, the more educational variety will flourish.

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Secrets of success

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America's system of higher education is the best in the world. That is because there is no system

AP

Larry Summers committed heresy

IT IS all too easy to mock American academia. Every week produces a mind-boggling example of intolerance or wackiness. Consider the twin stories of Lawrence Summers, one of the world's most distinguished economists, and Ward Churchill, an obscure professor of ethnic studies, which unfolded in parallel earlier this year. Mr Summers was almost forced to resign as president of Harvard University because he had dared to engage in intellectual speculation by arguing, in an informal seminar, that discrimination might not be the only reason why women are under-represented in the higher reaches of science and mathematics. Mr Churchill managed to keep his job at the University of Boulder, Colorado, despite a charge sheet including plagiarism, physical intimidation and lying about his ethnicity.

With such colourful headlines, it is easy to lose sight of the real story: that America has the best system of higher education in the world. The Institute of Higher Education at Shanghai's Jiao Tong University ranks the world's universities on a series of objective criteria such as the number of Nobel prizes and articles in prestigious journals. Seventeen of the top 20 universities in that list are American (see table in article); indeed, so are 35 of the top 50. American universities currently employ 70% of the world's Nobel prize-winners. They produce about 30% of the world's output of articles on science and engineering, according to a survey conducted in 2001, and 44% of the most frequently cited articles.

At the same time, a larger proportion of the population goes on to higher education in America than almost anywhere else, with about a third of college-aged people getting first degrees and about a third of those continuing to get advanced degrees. Non-traditional students also do better than in most other countries. The majority of undergraduates are female; a third come from racial minorities; and more than 40% are aged 25 or over. About 20% come from families with incomes at or below the poverty line. Half attend part-time, and 80% of students work to help support themselves.

Why is America so successful? Wealth clearly has something to do with it. America spends more than twice as much per student as the OECD average (about $22,000 versus $10,000 in 2001), and alumni and philanthropists routinely shower universities with gold. History also plays a part. Americans have always had a passion for higher education. The Puritans established Harvard College in 1636, just two decades after they first arrived in New England.

The main reason for America's success, however, lies in organisation. This is something other countries can copy. But they will not find it easy—particularly if they are developing countries that

are bent on state-driven modernisation.

The first principle is that the federal government plays a limited part. America does not have a central plan for its universities. It does not treat its academics as civil servants, as do France and Germany. Instead, universities have a wide range of patrons, from state governments to religious bodies, from fee-paying students to generous philanthropists. The academic landscape has been shaped by rich benefactors such as Ezra Cornell, Cornelius Vanderbilt, Johns Hopkins and John D. Rockefeller. And the tradition of philanthropy survives to this day: in fiscal 2004, private donors gave $24.4 billion to universities.

Limited government does not mean indifferent government. The federal government has repeatedly stepped in to turbocharge higher education. The Morrill Land Grant Act of 1862 created land-grant universities across the country. The states poured money into community colleges. The GI Bill of 1946 brought universities within the reach of everyone. The federal government continues to pour billions of dollars into science and research.

The second principle is competition. Universities compete for everything, from students to professors to basketball stars. Professors compete for federal research grants. Students compete for college bursaries or research fellowships. This means that successful institutions cannot rest on their laurels.

The third principle is that it is all right to be useful. Bertrand Russell once expressed astonishment at the worldly concerns he encountered at the University of Wisconsin: “When any farmer's turnips go wrong, they send a professor to investigate the failure scientifically.” America has always regarded universities as more than ivory towers. Henry Steele Commager, a 20th-century American historian, noted of the average 19th-century American that “education was his religion”—provided that it “be practical and pay dividends”.

This emphasis on “paying dividends” remains a prominent feature of academic culture. America has pioneered the art of forging links between academia and industry. American universities earn more than $1 billion a year in royalties and licence fees. More than 170 universities have “business incubators” of some sort, and dozens operate their own venture funds.

Nothing quite like it

There is no shortage of things to marvel at in America's higher-education system, from its robustness in the face of external shocks to its overall excellence. No country but America explores such a wide range of subjects (including some dubious ones such as GBLT—gay, lesbian, bisexual and transgender studies). However, what particularly stands out is the system's flexibility and its sheer diversity.

For a demonstration of its flexibility, consider New York University. NYU used to be a commuter school with little money and even less prestige. In the mid-1970s, it was so close to bankruptcy that it had to sell off its largest campus, in the Bronx. But today it is flush with money from fund-raising, “hot” with would-be undergraduates across the country, and famous for recruiting academic superstars. The Shanghai world ranking puts it at number 32.

The academic superstars certainly helped, but two other things proved even more useful. The first was NYU's ability to turn its location in downtown Manhattan into an asset. Lots of universities have fine economics departments, but having the stock exchange nearby adds something extra. The second was the university's ability to spot market niches.

Alamy

New York University: from underdog to top dog

What made all this possible was the fact that power is concentrated in the hands of the central administration. Most universities in other countries distribute power among the professors; American universities have established a counterbalance to the power of the faculty in the person of a president, which allows some of them to act more like entrepreneurial firms than lethargic academic bodies.

The American system's diversity has allowed it to combine excellence with access by providing a wide range of different types of institutions. Only about 100 of America's 3,200 higher-education institutions are research universities. Many of the rest are community colleges that produce little research and offer only two-year courses. But able students can progress from a humble two-year college to a prestigious research university.

To be fair, one reason why America's best universities are so good is that they have borrowed liberally from abroad—particularly from the British residential universities that grew up in Oxford and Cambridge in the Middle Ages, and from Wilhelm von Humboldt's German research university in the early 19th century.

Serpents in paradise

But America's academic paradise harbours plenty of serpents. The political correctness that has plagued Mr Summers is just one example of a deeper problem: America's growing inclination to abandon the very principles that have made it a world leader.

Ross Douthat has recently created a stir with his exposé of Ivy League education, “Privilege: Harvard and the Education of the Ruling Class”. High-school students compete furiously to get into Ivy League universities such as Harvard, but Mr Douthat, who graduated from there only three years ago, argues that they are seldom stretched when they arrive. A few professors try to provide overviews of big subjects, but many stick with their pet subjects regardless of what undergraduates need to learn. Mr Douthat wanted to pick a comprehensive list of classes in his chosen subjects, history and literature, but ended up with a weird mish-mash taught by “unengaged professors and overburdened teaching assistants”. Looking back on his experience, he feels cheated.

He is not alone. In many ways, undergraduates are the stepchildren of American higher education. Most academics pay more attention to research than to teaching, and most universities continue to neglect their core curriculums in the name of academic choice.

From time to time, universities try to improve the lot of the undergraduate, as Mr Summers is currently doing at Harvard: reforming the core curriculum, taming grade inflation and asking professors to concentrate on teaching rather than self-promotion. But reformers are fighting in hostile territory. The biggest rewards in academic life are reserved for research rather than teaching, not least because research is easier to evaluate; and most students are willing to put up with indifferent teaching so long as they get those vital diplomas.

Complaints about the neglect of undergraduate education are as old as the research university, but the past few years have produced a host of new criticisms of American universities. The first is that universities are no longer as devoted to free inquiry as they ought to be. The persecution of Mr Summers for the sin of intellectual rumination is symptomatic of a wider problem. At a time when America's big political parties are deeply divided over profound questions, from the meaning of “life” to the ethics of pre-emptive war, university professors are overwhelmingly on the side of one political party. Only about 10% of tenured professors say they vote Republican. The liberal majority has repeatedly shown that it is willing to crush dissent on anything from speech codes to the choice of subjects worth studying.

There are signs that scientists, too, are turning against free and open inquiry, though for commercial rather than ideological reasons. Corporate sponsors are attaching strings to their donations in order to prevent competitors from free-riding on their research, such as forcing scientists to delay publication or even blank out crucial passages from published papers. When Novartis, a Swiss pharmaceutical giant, agreed to invest $25m in Berkeley's College of Natural Resources, for example, it stipulated that it should get a first look at much of the research carried out by the plant and microbial biology department.

The second criticism is that America's universities are pricing themselves out of the range of ordinary Americans. Between 1971-72 and 2002-03, annual tuition costs, in constant 2002 dollars, rose from $840 to $1,735 at public two-year colleges and from $7,966 to $18,273 at private four-year colleges. True, the federal government spends over $100 billion a year on student aid, and elite universities make every effort to subsidise poorer students. One study of admissions to selective colleges shows that, in 2001-02, students with a median family income paid only 34% of the “sticker” price.

Still, the sheer relentlessness of academic inflation is worrisome. Elite colleges have little incentive to compete on price; indeed, they tend to compete by adding expensive accoutrements, such as star professors or state-of-the-art gyms, thus pushing up the cost of education still further. And the public universities that played such a valiant role in providing opportunities to underprivileged students are being forced to raise their prices, thanks to the continual squeeze on public funding. The average cost of tuition at public universities rose by 10.5% last year, four times the rate of inflation.

The dramatic rise in the price of American higher education puts a heavy burden on middle-class families who are too rich to qualify for special treatment. It also sends negative signals to poorer parents who may be unaware of all the subsidies available. Deborah Wadsworth, an opinion pollster, points out that universities may be courting a popular backlash. Americans increasingly regard universities as the gatekeepers to good jobs, but they also see them as prohibitively expensive. The result is a steady erosion of public admiration for these formerly much-esteemed institutions.

This points to a third criticism: that universities are becoming bastions of privilege rather than instruments of social mobility. From the 1930s onwards, America's great universities did much to realise the American creed of equality of opportunity. James Bryant Conant, Harvard's president from 1933 to 1953, opened up scholarships to academic merit, and the vast post-war expansion of higher education extended Conant's meritocratic principle to millions of students. “Flagship” public

universities such as Michigan, Texas and Berkeley, California, provided world-class education for next to nothing.

Meritocracy in retreat

But the march of academic meritocracy has now slowed to a crawl, and, on some fronts, has even turned into a retreat. William Bowen of Princeton University and two colleagues, in a study of admissions to elite universities, found that in the 11 universities for which they had the best data, students from the top income quartile increased their share of places from 39% in 1976 to 50% in 1995. Students from the bottom income quartile also increased their share very slightly: the squeeze came in the middle.

Mr Summers points out that Harvard now offers free tuition to students whose families earn less than $40,000 a year, and greatly reduced fees to students from families earning $40,000-60,000. Other elite universities have followed suit. Yet at the same time those universities give priority to athletes, people applying early (who often come from privileged backgrounds) and the children of alumni (“legacies”). Duke University encourages the offspring of wealthy parents to apply early and considers their applications sympathetically.

The real threat to meritocracy, however, comes not from within the universities but from society at large. One consequence of the squeeze on funding for public universities, created by Americans' reluctance to pay taxes, has been an academic brain drain to the more socially exclusive private universities. In 1987, seven of the 26 top-rated universities in the *US News & World Report* rankings were public institutions; by 2002, the number had fallen to just four.

The biggest risk to American higher education is the erosion of the competitive principle. The man often cited as the architect of American academia's current success is Vannevar Bush, who was director of the office of scientific research and development during the second world war. After the war he insisted that research grants be allocated to universities on the basis of open competition and peer review. But in the 1980s universities began undermining this principle by lobbying their local congressmen for direct appropriations. In 2003, the amount of money from the federal research budget awarded on a non-competitive basis topped $2 billion, up from $1 billion in 2000.

American academia's merits still outweigh its faults. Many American undergraduates are savvy enough to get a first-class education. Many academics resist the temptation to censor ideological minorities. The vast bulk of research grants are allocated on the basis of merit. Yet American universities are acquiring a growing catalogue of bad habits that could one day leave them vulnerable to competitors from other parts of the world—though probably not from Europe, which has overwhelming academic problems of its own.

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Head in the clouds

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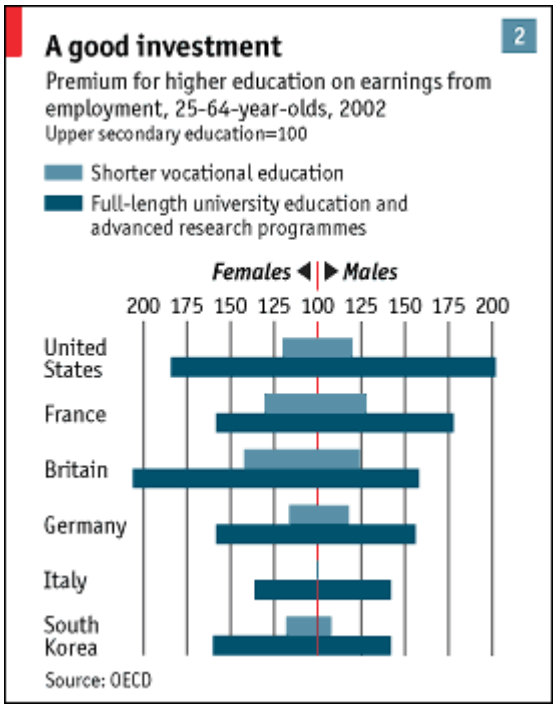
Europe hopes to become the world's pre-eminent knowledge-based economy. Not likely

THERE are few things European leaders like better than talking about their plans for turning Europe into the world's most competitive “knowledge-based economy” by the end of this decade. The aim was first laid out at the EU's summit in Lisbon in March 2000 and has been repeated with hypnotic fervour ever since.

To grasp the full absurdity of this ambition, it is worth visiting the Humboldt University in Berlin. Walk into the main foyer, stroll up the steps to the first floor past a slogan by a former student engraved in gold on the wall (“Philosophers have simply interpreted the world; the point is to change it”) and study the portraits of the Nobel prize-winners that line the walls. There were eight in 1900-09, six in 1910-19, four in 1920-29, six in 1930-39, one in 1940-49 and four in 1950-56. The roll of honour includes luminaries such as Theodor Mommsen, Max Planck, Albert Einstein and Werner Heisenberg. But after 1956 the Nobel prizes suddenly stop.



The list of Nobel prize-winners actually understates the university's past glories. In the 19th century, it not only nurtured such world-class intellectuals as Hegel and Fichte, it also pioneered a new sort of educational institution—the research university. And the drying-up of Nobel prizes in 1956 is not the only indication of the university's current plight. It occupies 95th place on the Shanghai list, next to the University of Utah. The buildings are drab, lectures and classes are overcrowded, and some of the best professors have left.

Apologists might retort that Humboldt is still recovering from its time on the wrong side of the Berlin Wall. Yet Humboldt's problems are replicated across the whole of Germany, west as well as east. The highest-placed German university in the Shanghai rankings is the Technical University of Munich, at 45. The ratio of students to teachers at German universities is depressingly high. For some lectures, a thousand or more students pile into the hall. The only count on which German universities still lead the world is the age of its students at graduation, 26 on average.

Their biggest problem is the dead hand of the state. The German government—both regional and central—tries to micro-manage every aspect of academic life, from whom universities employ to whom they can teach. The state has progressively starved universities of funds, not least because it has forbidden them from charging fees. It has also snuffed out academic competition. Universities have little power to pick their pupils and even less to attract star professors.

Belatedly, the Germans are beginning to recognise that their system is dysfunctional, not least because some of the brightest German students are voting with their feet and going abroad to study. The government is trying hard to encourage foreign students to come to Germany, though its success may have more to do with the fact that higher education is free to both domestic and foreign students than with the quality of the education purveyed. The government is also trying to make its universities more competitive by creating a German Ivy League. Furthermore, Germany's Constitutional Court has ruled against the federal government's ban on tuition charges, opening the way for universities to increase their revenues (and prompting protests from tens of thousands of students). But these reforms are only a beginning. German states controlled by the left are likely to continue to resist fees, and even the more conservative ones will charge only a nominal amount.

Universities are a mess across Europe. European countries spend only 1.1% of their GDP on higher education, compared with 2.7% in the United States. American universities have between two and five times as much to spend per student as European universities, which translates into smaller classes, better professors and higher-quality research. The European Commission estimates that 400,000 EU-born scientific researchers are now working in the United States. Most have no plans to return. Europe produces only a quarter of the American number of patents per million people. It needs to ask itself not whether it can overtake the United States as the world's top knowledge economy by 2010, but how it can avoid being overtaken by China and other Asian tigers.

The basic problems with the universities are the same across Europe: too much state control and too little freedom to manage their own affairs. Governments have forced universities to educate huge armies of students on the cheap, and have deprived them of the two freedoms that they need to compete in the international marketplace: to select their students and to pay their professors the market rate for the job.

Still, the Europeans are taking a couple of practical steps to improve their troubled universities. The Bologna Declaration, signed in 1999, is intended to produce a single European higher educational “space” by introducing a combination of comparable qualifications and transferable credits. Various EU initiatives are also encouraging young people to study in other European countries: the Erasmus programme, for example, has already benefited more than one million students. This combination of increased transparency and enhanced mobility is bound to promote competition among universities.

But this is all too little, too late. There has been little or no progress on introducing realistic fees, freeing universities from government control or concentrating research in elite universities. To understand how far most European countries still have to go—and how difficult it will be to get there—Britain offers some useful pointers.

Britain is a marked exception to the European pattern of complacency and decline. It has two universities in the top ten of the Shanghai rankings, Cambridge at number three and Oxford at number eight, and four in the top 30, a far better showing than any other European country. It also has one of the highest graduation rates in the OECD, with more than 30% of the relevant age group completing university or college, up from only 14% in the mid-1980s.

Half right

Britain's academics were aghast when Margaret Thatcher set about shaking up the universities in the early 1980s. Oxford even denied an honorary degree to the country's first female prime minister, an old alumnus. But the long-term effect of her policies, which have been continued and in some ways intensified under Labour since 1997, has been to leave British universities in a much better state than their continental rivals.

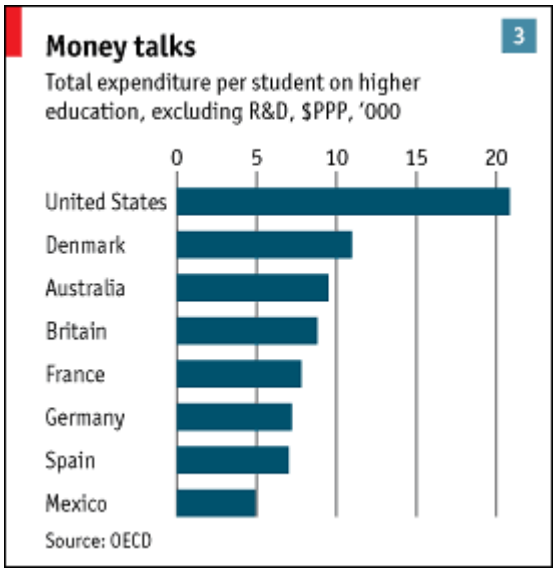
British universities have won a measure of freedom to charge tuition fees: the amount they can charge is set to triple to £3,000 next year. They are also learning how to raise money from both private business and alumni. If the most conspicuous figure on British campuses in the 1960s was the radical sociologist, the most conspicuous figure today is the academic entrepreneur. But Britain's universities still suffer from two vexatious problems.

DPA

Have the Germans lost the knack?

The first is government meddling. The government's determination to improve academic productivity is creating a Stalinist bureaucracy of “academic auditors” who cannot distinguish between make-work articles and genuine research, and its desire to open up access to higher education is creating a second Stalinist bureaucracy in the Office for Fair Access.

The second problem is a relentless financial squeeze. Successive governments have trumpeted improvements in productivity, which is supposedly rising by 1% a year. But too often this is just a synonym for the erosion of quality. In the 1990s, spending per student fell by more than a third, and the student-teacher ratio doubled from 9:1 to 18:1. Academic salaries have been falling by about 2% a year in real terms for two decades, and the army of part-time lecturers has grown ever bigger. Half the universities are running deficits.



This is undermining the country's ability to support world-class universities. Some of the finest scholars have been lost to foreign competitors. Just as damaging, the universities are being forced to eat into their capital. Oxford is currently running an operating deficit of £20m a year and an accumulated deficit on teaching and research of £95m. This is because the Treasury pays only about half of the estimated average of £18,600 a year it costs to teach an Oxford undergraduate, so the university and its colleges have to make up the difference from their own resources. The new top-up fees will help, but not enough to solve the university's problems.

The British government has led continental Europe in reforming its universities. It has established a system of student loans, and has crossed an important threshold in conceding the principle of “variable fees”. But the sort of managed market it has created, in which the government regulates what universities can sell and how much they can charge for it, is an unsatisfactory half-way house. It should now set the universities free.

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A world of opportunity

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Developing countries see the point of higher education

Imaginechina

Peking pulls them in

ACROSS the developing world, higher education is coming in from the cold. Gone are the days when it was purely a luxury for the elite. Governments are rapidly expanding their higher-education systems, with China probably witnessing the biggest expansion of student numbers in history. They are trying to create centres of excellence and throwing open the sector to private entrepreneurs.

The main reason for this flurry of activity is the dramatic growth in the supply of potential students. Secondary school enrolment rates have grown rapidly across the developing world. But there has also been a revolution in economic thinking. Not so long ago the World Bank pooh-poohed spending on higher education as both economically inefficient and socially regressive. Now many development economists are warming to higher education, pointing to the demand for graduates—as demonstrated by their wage premium—and to the positive effect of university-based research on the economy.

Nobody doubts the difficulty of building decent universities in the developing world. In most countries the legacy of colonialism has been compounded by the legacy of anti-colonialism. Colonialism meant that universities concentrated on producing a tiny group of elite administrators, and anti-colonialism tightened their bonds with government.

Public spending on universities in developing countries is highly regressive. In Latin America the professional classes, who account for 15% of the population, take up nearly half of all university places. In Rwanda, 15% of the total education budget is spent on the 0.2% of students who attend universities. Most universities in the developing world are also hopelessly badly managed.

But there are a few bright spots on the horizon. Some universities in poorer countries have been

doing world-class research. The botany department of the University of Sao Paulo, for example, was first to crack the genetic code of a bacterium called *Xylella fastidiosa*, which has been laying waste to vineyards in southern California. This work attracted global funding as well as attention from, among others, America's Department of Agriculture and the American Vineyard Foundation.

A second bright spot is that good management can produce striking improvements. Uganda's Makerere University, which in the late 1980s was on the verge of bankruptcy, has increased its student numbers fivefold and is investing in its infrastructure. It has introduced fees for 80% of its students, and now generates a third of its revenue from a variety of commercial ventures such as a bakery and an in-house consultancy.

A third cause for cheer is the proliferation of different kinds of universities. A few years ago most universities in the developing world were much the same: designed for the elite and dominated by the state. Now there is more variety. The biggest change is the emergence of a for-profit sector that concentrates on subjects such as accounting and computer skills, and often pioneers educational innovation.

What are the prospects that the good news will outweigh the bad? To answer this question, it is worth looking more closely at the two countries that are currently conducting the world's biggest experiments in the “massification” of higher education: India and China.

India's higher-education system has plenty of inherited handicaps. Some of them are left over from colonialism and some from anti-colonialism; some arise from poor management and political confusion. B.S. Baswan, the country's secretary for secondary and higher education, notes that his sector lacks a clear political constituency. Yet the problem is deeper than that: the government does not have the resources to fund the expansion it wants, but cannot summon up the political courage to start charging students realistic fees. The result is that India often seems to take one step back for every two steps forward.

Undoubtedly, though, it is making advances. The number of people attending universities almost doubled in the 1990s, from 4.9m to 9.4m. The price of this has been a decline in overall quality. That said, India has two valuable things going for it. One is its collection of elite institutions. For decades, India has been pouring resources into the All India Institute of Medical Sciences, the Indian Institute of Science in Bangalore and, above all, the Indian Institutes of Technology. These institutions take their pick from an army of candidates every year, with 180,000 hopefuls taking the screening test for around 3,500 places in the seven IITs. They provide a highly intensive education, with all students and often professors too living on campus. And they produce a stream of highly educated people who help to set professional standards. “They are a class apart, like Oxford and Cambridge,” says P.V. Indiresan, an expert on universities.

These elite institutions help to keep India plugged into the global knowledge economy. R.S. Sirohi, the former director of IIT Delhi, explains that he used to give his staff long sabbaticals in western universities, and that about a third of them spend time in America every summer. His institute receives sponsorship for research from multinationals such as Sun Microsystems, Cisco, Volvo and Ford. Granted, the elite institutions produce many people who get brain-drained away, but they also keep many bright people from emigrating, and may even attract émigrés back if India's economy keeps booming. It is accepted wisdom in India that the brightest students go to the IITs and the second-best to American universities.

India's other big advantage is a more recent development: a booming private sector. This being India, the sector is plagued by scandal. In February, India's Supreme Court ordered the closure of nearly 100 private universities because of quality concerns. Still, the best private colleges are doing admirable work, responding to unmet demand for technical and managerial education, often in highly creative ways, correcting India's bias towards theoretical education, and encouraging

entrepreneurs to pour millions into a sector that has traditionally been starved of funds.

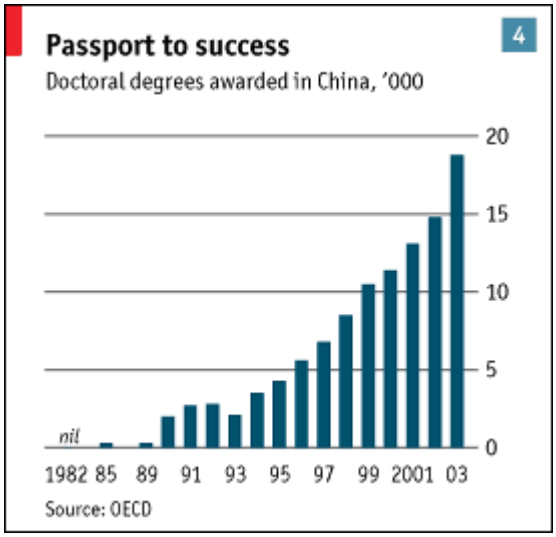
Vinay Rai, a telecoms and steel magnate, is just such an entrepreneur. Rai University bills itself as “India's best private university”, with 16 campuses across the country. Mr Rai wants the university to fill a gap in the market, and sees huge demand for education in practical subjects such as management, media, accounting and tourism. But he is interested in more than just tapping a booming market, pointing out that half his students are on scholarships. He wants to shift from training obedient clerks towards training self-starting entrepreneurs. He waxes lyrical about the “beautiful model” of higher education he encountered in America at the Massachusetts Institute of Technology.

The contrast between Rai University's main campus in Delhi and that of Jawaharlal Nehru University, one of India's most distinguished public universities, is striking. Rai University is spick and span whereas JNU is sprawling and untidy. Rai is full of computers, whereas JNU is resolutely low-tech. Rai's students are determined to take part in the global economy, whereas JNU is plastered with signs protesting against the evils of capitalism.

A growing band of successful private companies are pioneering the democratisation of technical education. NIIT, a computer-training company, has 40 wholly owned centres and more than 1,000 franchised operations, and is expanding to America and Britain. It has also established a research-and-development department to discover the most effective teaching methods. One of its cleverest ideas was to give illiterate children free access to computers in order to see how easily they could master them. It has also established links with Citibank to enable students to take out loans to pay fees. The company has become such a brand name that some advertisements in the matrimonial pages of the *Times of India* specify graduates of NIIT.

China enrols the market

In higher education, as in so much else, China is visibly pulling ahead of India. The Chinese are engaged in the biggest university expansion in history. In the 1980s, only 2-3% of school-leavers went to university. In 2003, the figure was 17%. The watershed year was 1999, when the number of students enrolled jumped by almost half. The expansion at the doctoral level is even faster than for undergraduates: in 1999-2003, nearly 12 times as many doctorates were awarded as in 1982-89 (see chart 4). And there is more to come: the number of new doctoral students jumped from 14,500 in 1998 to 48,700 in 2003.



The Chinese are determined to create a super-league of universities to rival the best in the world. The central government is investing heavily in chosen universities, such as Peking, Tsinghua and Fudan, offering higher salaries and more research funding. The state governments are doing likewise. It is no accident that the most widely used annual ranking of the world's research universities, the Shanghai index, is produced by a Chinese university.

What lies behind all this is a gigantic exercise in technology transfer. The Chinese are trying to recreate the best western universities at home in order to compete in more sophisticated industries. They have stocked up with foreign PhDs: in some departments of the University of Peking, a third of the faculty members have American doctorates. They are using joint ventures with foreign universities in much the same way as Chinese companies use joint ventures with foreign companies.

The Chinese have no qualms about using market mechanisms to achieve this technology transfer. Tuition charges now make up 26% of the earnings of public universities, nearly twice the level in 1998; many professors are paid according to the number of students they attract; and China is creating a parallel system of private universities alongside the public ones. For example, the University of Peking has more applicants than places, so it has created a parallel university that charges higher fees and accepts slightly less able students. Links between universities and industry are commonplace. The majority of doctorates earned in China between 1992 and 2003 were in practical subjects, which attract the brightest students: engineering (38% of the total), natural sciences (22%) and medicine (15%).

But will China achieve its academic ambitions? The trouble is that investment will not do the trick without broader cultural changes. Rui Yang, a professor at Australia's Monash University, points out that academic corruption is rife. The powerful academies that distribute much of the research funding are prey to both political favouritism and lobbying. Plagiarism is commonplace. Many academics use a good part of their research funding for personal rather than academic ends.

The country's authoritarianism will also prove a limiting factor, affecting not only the humanities but the sciences as well. For example, Chinese scientists suppressed information on SARS because it contradicted the official line. A world-class university without freedom of thought is still a contradiction in terms.

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Wandering scholars

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From The Economist print edition

For students, higher education is becoming a borderless world

Eyevine

Thoroughly international Berkeley

BILL CLINTON tells a nice story about the first time he set eyes on Oxford University. He was dropped off at his college at 11pm on a rainy October night, together with three other Rhodes scholars. One of them was Robert Reich, his future labour secretary, who is exceedingly short. The four Americans walked into the college's main quadrangle, a splendid 17th-century edifice, and marvelled about the wealth of history facing them. But they were immediately brought down to earth by the head porter, Douglas Millin, who complained that he had been promised four Yanks, but had been sent only three and a half.

In Mr Clinton's student days, international education was still the preserve of a small elite of potential superstars. Today it is undergoing the same process of “massification” that has reshaped domestic higher-education policy. The number of foreign students in the OECD (see chart 5) has doubled over the past 20 years, to 1.5m.

What is driving this solid growth? The two most obvious things are the magnetic power of the world's top universities and the under-supply of university places in the developing world. The world's brightest students—and particularly its brightest graduate students—want to study at the world's best universities. Half the world's students live in developing countries where the supply of university places cannot keep up with the demand. Two of the biggest exporters of students in absolute numbers are China (with 10% of all those studying abroad) and India (with 4%).

In recent years several other things have speeded this growth even further. One is competition for talent. A growing number of rich countries are rejigging both their education and their immigration policies in order to attract highly qualified workers. A second is competition for the tuition fees that foreign students have to pay, which is particularly fierce from countries that will not allow their universities to charge realistic fees to home-grown students. Oxford has recently doubled the proportion of its overseas students, to 15%; at the London School of Economics, 75% of graduate students are from abroad. A third factor is the EU's policy of sponsoring student mobility within the Union so as to create a European identity among the young.

Several countries—most notably Australia and New Zealand—are trying to turn education into an export industry. Foreign students are triply valuable. They pay fees to universities, spend money on things like food and lodging, and may even end up staying on permanently. What better way to shift your economy from its traditional reliance on primary production?

For the past 50 years America has effortlessly dominated the market for international students, who have brought both direct and indirect benefits. Not only are they contributing some $13 billion a year to America's GDP, they are also supplying brainpower for its research machine and energy for its entrepreneurial economy. But now America's leadership is under challenge. The Institute of International Education reports that the number of foreign students on American campuses declined by 2.4% in 2003-04, the first time the number has gone down in 30 years. Foreign applications to American graduate schools fell by 28% last year, and actual enrolment dropped by 6%.

Coming after decades of steady growth, these figures sent shock waves through the academic

system. Many American universities initially blamed the tightening of visa rules after September 11th 2001 and lobbied furiously for reform. Visa policy clearly played a part, but in fact America has been losing market share among international students since 1997. The biggest reason for that is foreign competition. In 2002-04 the number of foreign students increased by 21% in Britain, 23% in Germany and 28% in France. A growing number of European countries are offering American-style degree programmes taught in English. Germany has the added attraction of dispensing university education free to foreigners as well as to domestic students. Universities in the developing world, too, are expanding rapidly, and often a booming domestic job market stands ready to absorb the resulting graduates.

Yet it would be a mistake to equate America's loss of its quasi-monopoly in the supply of higher education to foreigners with long-term decline. For one thing, the market is likely to continue to grow rapidly as Asia produces its own mass middle class. For another, American universities are well placed to operate in the global market for student talent. In the past, American universities have been at their best when competing for faculty or domestic students. Why should foreign students be any different?

Brain circulation

The spectacle of so many bright people from poor countries upping sticks for the rich world raises questions of social justice, in part because they contribute both money and brainpower to their host country while they are studying and in part because so many of them end up staying permanently. Some people see the development as a kind of neo-colonialism of the mind. But there is no guarantee that all these bright people would have prospered if they had stayed at home. The combined net worth of Indian IIT graduates in America is reportedly $30 billion. But would all those brilliant Indians have become so rich if they had stayed in India? “Better brain drain than brain in the drain,” was the much-quoted verdict of the late Rajiv Gandhi, an Indian prime minister.

Perhaps what is going on is not so much a “brain drain” as “brain circulation”. The governments of many developing countries encourage bright students to go abroad, often using scholarships as

inducements, as part of a general policy of “capacity-building” so they can plug themselves into the latest thinking in the West.

Few highly skilled migrants cut their links with their home countries completely. Most keep in touch, sending remittances (and, if they are successful, venture capital), circulating ideas and connections, and even returning home as successful entrepreneurs. A growing number of Indian and Chinese students go home after a spell abroad to take advantage of the hot labour markets in Shanghai or Mumbai. And a growing number of expatriate businessmen invest back home.

Increasingly, developing countries encourage foreign universities to come to them, rather than sending their students abroad. Singapore has established close relations with 15 partners, including such elite institutions as Stanford, Cornell and Duke Medical School. Dubai has established a “knowledge village” with 13 foreign universities, and Qatar an “educational city” with four, largely for the benefit of Middle Easterners who want a western education but think they may no longer be welcome in America.

Some developing countries are even establishing themselves as educational middlemen: importers as well as exporters of talent. China not only sends the most students abroad but is also one of the leading hosts in the Asian region. Between 1998 and 2002 the number of international students in the country doubled, from 43,000 to 86,000. Malaysia sends lots of its own students abroad in an effort at “capacity-building”, but is also actively recruiting students from China and Indonesia, and increasingly from Pakistan and other Islamic countries.

The problem with equity arises not so much between the rich and the poor world but within the developing world. As a rule, only the developing world's elites attend foreign universities. The Ford Foundation is devoting huge resources to putting this injustice right: in 2000 it provided $280m over 12 years—its biggest-ever grant—for a scholarship programme to send disadvantaged people from poor countries to leading universities abroad. Douglas Millin is, alas, no longer with us. But if the Ford Foundation has its way, his successors will have to deal with people from considerably farther afield than Hope, Arkansas.

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Higher Ed Inc

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Universities have become much more businesslike, but they are still doing the same old things

AP

The way we learn now?

THE University of Phoenix's Hohokam campus looks more like a corporate headquarters than a regular university. There is none of the cheerful mess that you associate with student life. The windows are made from black reflecting glass, the corridors are neat and hushed, the grass has been recently cut, there is plenty of parking space for everybody, and security guards in golf carts make sure all the cars are on legitimate business. The university is conveniently close to a couple of motorways, and ten minutes from the airport.

But the campus does not just look like a corporate headquarters; it is one. The University of Phoenix is America's largest for-profit university (and indeed America's largest university, full stop), with 280,000 students, 239 campuses and various offshoots around the world, including some in China and India. The Hohokam campus houses the corporate headquarters of the Apollo Group, the company that owns the university, along with the group's corporate university.

The University of Phoenix was the brainchild of John Sperling, a Cambridge-educated economist turned entrepreneur. When he was teaching in San Jose State University in the early 1970s, Mr Sperling noticed that adult students got scant attention from universities designed to teach people aged 18-22. That, he felt, was not only unfair but also unwise: in the new economy, workers might have to keep going back to university to update or improve their skills.

The University of Phoenix is designed to cater for the needs of working adults, who make up 95% of its students. The emphasis is on practical subjects, such as business and technology, that will help them with their careers, and on fitting in with busy schedules. One of the university's golden rules is that there should be plenty of parking, and that students should be able to get from their cars to their classrooms in five minutes. In the early 1990s it became the first university to offer

degrees online, and the internet is now integral to all its teaching.

But in designing a university for working adults, Mr Sperling also introduced two other far-reaching innovations. The first was to concentrate power in the organisation. In traditional universities academics are semi-independent contractors who devote as much time as possible to their own research. In Phoenix they are simply employees. It is the university, not the teachers, that owns the curriculum. Todd Nelson, the company's boss, claims that this has allowed the university to become a “learning organisation”: it is constantly improving its ability to teach by measuring performance and disseminating successful techniques. The only research it cares about is the sort that improves teaching.

The second innovation is to turn higher education into a business. The cost of a year's education at Phoenix, at $9,000, is not particularly high for a private university, but the business ethos is unusually pervasive. Mr Nelson cheerfully talks about “the education industry”, and boasts that enrolment is currently growing at 25% a year. The Apollo Group spent a staggering $383m on marketing last year.

Dollars and degrees

It is hard to imagine what von Humboldt, with his belief in research for its own sake, would make of the University of Phoenix. But for many people it is a vision of the future. Milton Friedman, a Nobel prize-winning economist, regards the triumph of the for-profit sector as inevitable, because universities “are run by faculty, and the faculty is interested in its own welfare.”

For-profit universities are finding a growing number of market niches, particularly in America. Strayer University, one of the University of Phoenix's biggest competitors, concentrates on telecommunications and business administration. Concord Law School, owned by Kaplan, which in turn is owned by the *Washington Post*, boasts one of the largest law-school enrolments in the country. All of its teaching is online. Cardean University, the brainchild of Michael Milken, offers online business education, including MBAs.

The Apollo Group's corporate university marks another big educational change. The number of corporate universities, which provide education for their parent companies, has grown from 400 in the mid-1980s to more than 2,000 today. Some of these institutions, such as the McDonald's Hamburger University, do not deserve the name, but others, such as those set up by Microsoft and Schwab, are more serious. A growing number of corporate universities are awarding degrees in conjunction with traditional universities.

For-profit universities are only the most dramatic example of a more general trend: the changing balance of power between the state and the market. For much of the 20th century the state steadily tightened its grip on universities. Now the market is beginning to get its own back.

The old-fashioned public universities are becoming ever more promiscuous in their pursuit of income. In America, “public university ” is fast becoming a figure of speech. At the University of Virginia, the share of the operating budget coming from the state declined from about 28% in 1985 to 8% in 2004. As one university president put it, his university has evolved from being a “state institution” to being “state-supported”, then “state-assisted”, next “state-located” and now “state-annoyed”.

In other countries too, public universities are becoming more entrepreneurial. Increasingly they are starting to charge fees, usually in combination with student loans. They are also transforming themselves into competitive commercial operations when it comes to attracting fee-paying foreign students or winning contracts with business. At the same time, new non-profit private universities

are springing up. These have long been common in America, Japan and South Korea, but used to be rare elsewhere. In Portugal, private universities and colleges have grown from almost nothing two decades ago to account for two-thirds of all higher-education institutions and 40% of all students. All in all, private funding has grown faster than public funding in seven of the eight OECD countries for which data are available.

Another eye-catching change is the rise of the internet as a way of delivering tuition. The internet has all sorts of advantages, from lowering costs to opening up markets. MIT has struck up an innovative alliance with two Singaporean universities that allows Singaporean students to take part “virtually ” in MIT lectures. The Virtual University of Monterrey, Mexico, uses a combination of teleconferencing and the internet to reach more than 70,000 students all over Latin America.

But for all the new technology and the “marketisation” of higher education, it is striking how little has changed. Traditional universities are raising money not so that they can do radically new things but so that they can continue to do the same old things. For-profit universities are undoubtedly doing an excellent job in filling market niches, particularly for technical education, but their position in the academic hierarchy remains humble.

The internet is producing equally modest results. However good it is for transmitting information or reinforcing learning, e-learning is no substitute for bricks-and-mortar universities. The e-learning bubble of the late 1990s burst with shocking speed. Fathom, a joint venture established by Columbia and 13 other universities, libraries and museums, closed down after raising revenues of only $700,000 in two and a half years. Caliber, the Wharton School's e-partner, filed for bankruptcy. Temple University abandoned Virtual Temple without offering a single course. NYU Online has also pulled the plug.

New technologies generally prompt heady predictions that they will revolutionise higher education. Thomas Edison forecast that motion pictures would replace campus lectures; others have made even grander claims for radio or television. David Noble, a historian, compares the internet craze with the fashion for correspondence schools that bubbled up in the early 20th century. By 1919, more than 70 American universities had launched correspondence courses, competing against some 300 private correspondence schools. But the bubble eventually burst, partly because of poor teaching and high drop-out rates but mainly because the human dimension was missing.

None of this is to say that the idea of the university is carved in gothic stone. It is indeed changing, but by evolution rather than revolution. And the most important recent development in the world of higher education has been the creation of a super-league of global universities that are now engaged in a battle for intellectual talent and academic prestige.

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The best is yet to come

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A more market-oriented system of higher education can do much better than the state-dominated model

Bridgeman Art Archive

The way they used to learn

WILLIAM JAMES had good reason to be nervous when he turned up, back in 1869, to be examined for his Harvard medical degree: he had spent most of the previous three years abroad. But as luck would have it, his examiner turned out to be Oliver Wendell Holmes, an old family friend. Dr Holmes asked the candidate a single question and, when young William answered it correctly, drew the event to a close: “That's enough! If you know that, you must know everything. Now tell me, how is your dear old father?”

For at least its first 200 years, Harvard was a finishing school for Boston's—or at most New England's—elite. Eliots and Lowells held leadership positions continuously for more than two centuries, and Cabots and Lodges kept appearing on the school rolls in various permutations. But starting in the late 19th century, Harvard gradually transformed itself into a national university. Now the university is undergoing another dramatic transformation: from a national to a global university.

This is not to say that Harvard is losing its American roots entirely. America is, after all, the world's greatest marketplace for higher education, and Harvard's very Americanness is part of its attraction. All the same, the university is increasingly operating in a global labour market. Faculty searches are always worldwide; in some departments 40% of PhD students come from abroad; and the graduate and professional schools are truly multinational.

Harvard is not alone. The great universities of the 19th century were shaped by nationalism; the great universities of today are being shaped by globalisation. The world's higher-education system is increasingly dominated by a superleague of world-class universities competing with each other for talent and prestige.

There is nothing new about globalism in higher education, of course. Medieval scholars communicated in Latin and often studied at several universities in different countries. But for a long time many academics felt that their principal loyalty was to their university or college rather than to their discipline. Universities were mainly schools for national bureaucrats and seminaries for nationalist ideas.

Today there are fewer restraints on universities' natural inclination towards internationalism. The top universities are citizens of an international academic marketplace with one global academic currency, one global labour force and, increasingly, one global language, English. They are also increasingly citizens of a global economy, sending their best graduates to work for multinational companies. The creation of global universities was spearheaded by the Americans; now everybody else is trying to get in on the act. The current vice-chancellor of Oxford, John Hood, hails from

New Zealand, and his counterpart at Cambridge, Alison Richard, spent 30 years teaching at Yale.

Global universities do not have to have a physical presence abroad to be worthy of the name. Some of the world's best universities have been reluctant to set up campuses abroad, and some of the most enthusiastic offshorers, such as Webster University, which runs seven overseas campuses from its headquarters in Missouri, are hardly global in the sense of having world-class faculty and the pick of the world's graduate students. However, a growing number of the world's top universities are getting more enthusiastic about offshoring.

It pays to be world-class

The most obvious reason for the rise of the global university is science's appetite for money and manpower. MIT's Lincoln Laboratory, for example, employs nearly 2,400 people and spends $450m a year on research. Access to global labour markets is needed to put together first-rate teams of researchers. But policymakers have also begun to realise that world-class universities produce a disproportionately large share of cutting-edge ideas and research. Look at the University of Chicago's impact on economics, and hence on economic policy. Of the 55 economists who have won the Nobel prize since 1969, when economics was added to the roster, nine were teaching at the University of Chicago when they were awarded their prizes, and another 14 either trained at Chicago or had previously taught there.

World-class universities can also produce outsize economic benefits. The best-known example of this is Stanford, which helped to incubate Google, Yahoo!, Cisco, Sun Microsystems and many other world-changing firms. But there are plenty of others. The University of Texas at Austin has helped to create a high-technology cluster that employs around 100,000 people in some 1,700 companies. In 2000, the eight research universities in Boston provided a $7.4 billion boost to the region's economy, generated 264 new patents and granted 280 licences to private enterprises.

Top universities are a valuable asset in the global war for talent too. America's great research universities enable it to recruit more foreign PhD students than the rest of the OECD put together. And a striking number of these people stay put: in 1998-2001, about two-thirds of foreigners who earned American doctorates in science and engineering said they had “firm plans” to stay, up from 57% in 1994-97.

The benefits of having global universities are now so clear that governments around the world are obsessed with producing “Ivy Leagues”. The British are introducing fees in part because they want their best universities to be able to compete with the best American ones. The German Social Democratic Party—traditionally a bastion of egalitarianism—has produced a plan to create German equivalents of Harvard, Princeton and Stanford. And the Chinese are hard at work trying to build world-class universities. Today “excellence” is taking over from “expansion” as the mantra of higher education.

But this academic revolution has only just begun, particularly in continental Europe. How can you create world-class universities if your academics are civil servants trapped in a national labour market? Only 2% of French academics are foreign-born. The comparable figure in Switzerland, which is much more successful at producing top universities, is 25%. Only 7% of newly hired professors in major American universities are alumni of the institutions where they teach. In France the figure is 50% and in Spain 95%. And how can you have world-class universities without proper resources? Hardly any continental European universities employ professional fund-raisers. Most do not even keep in touch with their alumni.

The new global universities are shaking up everything from academic funding to immigration laws. But they also manage to mix a large measure of conservatism with their radicalism. For the most

part, they are still the children of the century-old marriage between the German research university and the British residential university. Most of them still try to combine teaching with research.

Over the past century, there have been various attempts to unbundle the two. The Chinese and Russians created pure research institutes. The French trained their elites in *grandes écoles*—professional schools that did not emphasise research. But for the most part these alternatives have failed.

A striking number of research universities have also preserved the idea of the academic village. A handful of hermits apart, most scholars prefer to live in a community of scholars in which academic and social life are melded together, preferably in beautiful surroundings. James Watson's account of a walk in Cambridge after he and Francis Crick discovered the double helix of DNA makes the point perfectly:

> I slowly walked toward the Clare Bridge, staring up at the gothic pinnacles of the King's College Chapel that stood out sharply against the spring sky. I briefly stopped and looked over the perfect Georgian features of the recently cleaned Gibbs Building, thinking that much of our success was due to the long, uneventful periods when we walked among the colleges or unobtrusively read the new books that came into Heffer's Bookstore.

European universities these days are given to nostalgia. Professors reminisce about an age when public money was plentiful, governments left them alone and academics were part of the ruling class. Students remember when the government picked up the tab for tuition and living costs. And almost everybody complains that quality has declined.

In reality, though, that golden age was never quite as wonderful as it is now made out to be. The public universities were never as democratic or egalitarian as they seemed. The justification of offering free higher education is that nobody should be denied it on cost grounds. But in practice the children of the privileged have long been much more likely to get into university than the children of the poor. The result was perverse: in the name of equality, all taxpayers were forced to subsidise the privileged.

These public universities often spiced de-facto elitism with anti-business snobbery. Many universities were not just reluctant to be “knowledge factories”; they were antagonistic to the capitalist economy. Oxford and Cambridge long resisted the study of practical subjects such as business or engineering; instead, they specialised in turning the sons of businessmen into educated gentlemen. This anti-business bias reached its apogee in the 1960s, when many of the current generation of dons got their jobs.

In the long run, the universities' deal with the state proved to be a bargain with the devil. In the days when universities were restricted to elites, the bargain worked well enough for the few; hence the nostalgia. But the moment that academia embarked on massification, this gentlemanly bargain broke down. Universities were forced to do more with less because the government faced lots of competing demands for funds. And academics were increasingly treated like other public servants—and held accountable for their use of public money.

Alamy

The more market-oriented model of higher education that has been pioneered in the United States, and is gradually spreading to much of the rest of the world, has four big advantages over the public model. First, it is better at combining equity with excellence. America sends a higher proportion of poor school-leavers to college than, say, Germany, which justifies its free universities by claiming

they offer universal access. Second, it is better at producing a diverse system that stretches from the Ivy League to community colleges. Governments can engineer differentiation in higher education, but state-sponsored differentiation tends to degenerate into academic apartheid. Third, the market model is much more sustainable than the public-sector model. Putting all your eggs in one basket is never very sensible; it is particularly silly if you belong to an elitist institution that comes low in the pecking order for public resources. Fourth, serving many masters gives universities much more control over their own destiny than being beholden to a single patron.

Wanted: 21st-century Humboldts

That is not to say that the transition to a more market-oriented system will be easy. Countries will have to solve the problem of social justice by allowing students to borrow against their future incomes. They will also have to cope with a host of new problems that come along with newly liberated markets. How do you prevent the erosion of the intellectual commons (for example, by companies preventing "their" scholars from publishing commercially sensitive material)? How do you regulate foreign universities? How do you deal with differences in national standards? How do you prevent outright cheating, such as selling degrees? These are serious problems. But they pose far less of a threat to universities than the slow starvation that accompanies public funding.

Empires of the mind

There are two other big reasons to be optimistic about universities. The first is the way they are increasingly regarded as the engines of the knowledge economy. This means that all sorts of people—from governments to companies to students—have a big incentive to keep investing in them. The second is that universities—particularly global research universities—have achieved such striking successes in advancing knowledge. To be sure, their recent record in the humanities has been decidedly mixed; but the sciences have never been healthier. For the people who are mapping the genome or looking for a cure for cancer, arguably the golden age of the university is now.

Noel Annan, the very embodiment of the British academic establishment, once said that universities "exist to cultivate the intellect. Everything else is secondary." The most precious gift that universities can offer is to live and work among books and laboratories, he argued; and the most important lesson they can teach is how to use the intellect:

> A university is dead if the dons cannot in some way communicate to the students the struggle—and the disappointments as well as the triumphs of that struggle—to produce out of the chaos of human experience some grain of order won by the intellect.

Three cheers to that. There are plenty of justifications for the revolution that is sweeping through higher education, most notably in the United States. It is giving students more control over where they get educated. It is giving millions of youngsters a chance to spend their formative years abroad. It is throwing up colleges that can teach managerial and technical skills. It is reconnecting academics with the wider knowledge economy. But the most important justification of all is that it is freeing resources for intellectual activity. It is filling libraries with books. It is stocking laboratories with equipment. And it is giving more researchers than ever before a chance to produce order out of chaos.

Von Humboldt's university with its emphasis on research was one of the transformative institutions of the 19th century. The emerging global university is set to be one of the transformative institutions of the current era. All it needs is to be allowed to flourish.

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Acknowledgments and sources

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From big business to big government

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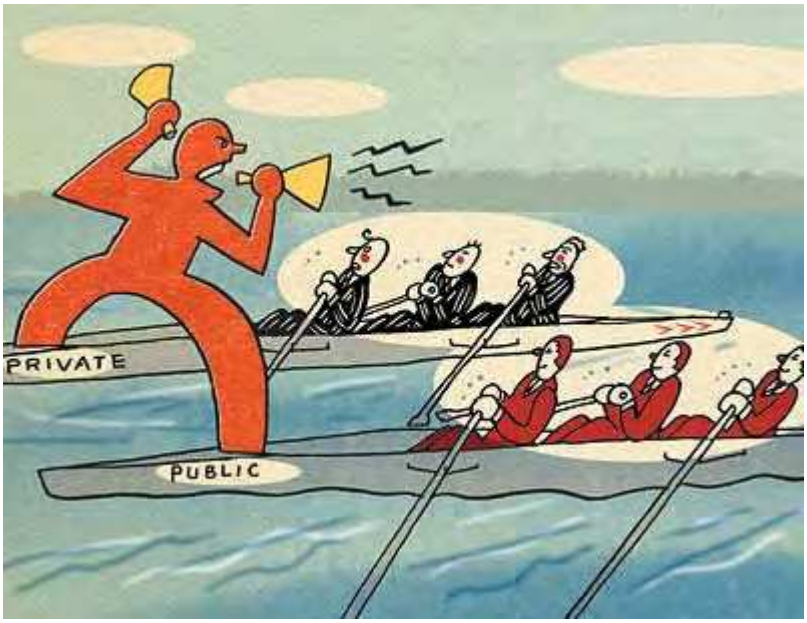

How public-sector work is reshaping management-consultancy

MANAGEMENT consultants used to be people with MBAs and large egos who wanted to reinvent General Electric. But more and more of their work is for the public sector these days, and that is changing the nature of the business.

Kennedy Information, an American firm that monitors the consulting industry, estimates that the public sector (including health care, which straddles both public and private sectors) now accounts for over 30% of the global consulting market. Kennedy forecasts that the business will grow by 6-9% for each of the next three years; private-sector business, it says, will grow by only 1-4% over the same period.

Britain's Management Consultancies Association (MCA) reckons that the value of public-sector consulting to its members grew by 46% last year, while private-sector business grew by only 4%. Two-fifths of the British consulting business of Deloitte, one of the Big Four accounting firms, is now for the public sector. Moreover, much private-sector work is for privatised businesses that are still shedding public-sector habits. In Britain last year, for the first time ever, utility companies (gas, electricity and water) were the biggest single private-sector market for the MCA's members.

Ralph Shrader, the chairman and chief executive of Booz Allen Hamilton, the American consulting firm with the strongest public-sector practice—its headquarters are in McLean, Virginia, deliberately close to Washington DC—says that he is seeing many more consultants “wandering the corridors of DC” than in previous years. Booz Allen has traditionally divided its business into

two streams; one for public-sector work and one for the private sector. It recruits separately for the two streams, and employees follow different career paths and different pay structures.

But the firm is reviewing this way of working, because the public sector is increasingly interested in importing ideas from business. These days even three-star generals and senior civil servants want to learn from the best in the commercial world. About 10% of Booz Allen's work is now in what Mr Shrader calls “the joint arena”, where consultants from both streams work in mixed teams. This is putting pressure on the firm to come up with a new single career path that combines the two types of work.

Even better, from the consultants' point of view, government departments and agencies are ever more willing to pay private-sector prices for consulting work. In the past they tended to feel obliged to go for the lowest-cost bidder, which (witness their many troubled IT projects) meant that they did not always get the best service. But in America and Britain in particular, there is a growing acceptance, especially in health care and education, that one way to stretch limited public-sector funds may be to introduce the best private-sector management practices. Booz Allen is currently working with America's Department of Health to improve the process of distributing vaccines for its immunisation programme. Peter Allred, a consulting partner at Deloitte, says that America's Department of Homeland Security, which has been willing to pay top rates for consulting services, has been influential in changing government attitudes.

Work practices promoted by the Department of Homeland Security may, however, be a little less fashionable after the mishandling of Hurricane Katrina. In any case, the strategy of importing management consultants into the public sector is already controversial in some quarters. In June, the annual congress of the GMB, a large British trade union, was told that the British government had spent more than £1.4 billion ($2.6 billion) on consultants in the 2003-04 fiscal year, a 40% increase on the year before. “The taxpayer is paying far too much for management and consultancy advice,” said Paul Kenny, the union's acting general secretary. “The culture of continual reorganisation in the public sector is creating a field day for consultants.” McKinsey, a blue-chip consulting firm that has long worked in both public and private sectors, says that the scale of the more expensive firms' involvement with government has been exaggerated. It puts its share of the British government's spending on consultancy at less than 2%.

Nevertheless, top-notch firms that have worked predominantly for the private sector are ever more keen to pitch for government business, particularly since they now believe it can be eased into their existing organisations. Steve Gunby, chairman of the American arm of the Boston Consulting Group (BCG), says that public-sector work at his firm is growing at double-digit annual rates. But BCG is not intending to set up a separate government practice. “We are,” says Mr Gunby, “keeping public-sector work completely integrated in the business.” Elgar Peerschke, the head of the North American health-care business at Bain & Company, says that his firm would not take on government business that was not similar to its private-sector work. It would not, as some other firms do, “work at different price points”.

For the moment, these firms can afford to be choosy. After some bad years in the wake of the dotcom bust, a few of the top firms are beginning to see their private-sector business take off again. At both BCG and Bain, it has probably been growing at healthy double-digit rates for the past couple of years. In any case, there is a severe constraint on their ability to take on new business: a shortage of suitably qualified people to do the work. Super-confident MBAs are much less keen to work for consultants than they were a few years ago, and working for the public sector is also unfashionable.

Consulting firms have been turning to new sources—PhD students, the military and (in the burgeoning health-care business) doctors. Some have been looking abroad. Bain, for example, hires MBA equivalents in India and brings them to America, where they are trained in its offices for

a year or two. Another firm has been looking to see whether it can lure European MBA students specifically to do public-sector work in America. Too many MBAs from blue-chip American business schools still believe they were born to reinvent General Electric.

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Disneyland

Year of the mouse

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Will Disneyland work in Hong Kong?

EPA

Mickey blends in

HONG KONG is in the grip of Mickey mania. It is pouring, unbearably humid and the official opening on September 12th is days away. But Hong Kong Disneyland is already packed. During a "rehearsal" last week it attracted close to its 30,000 daily capacity, forcing visitors to queue for hours. Ten thousand a day could visit from China's mainland alone: hundreds of extra border guards are in place this weekend in readiness.

It is a good omen for those hoping to profit from Asia's newest theme park—six years in the making at a cost of $3.5 billion. One is Walt Disney itself. This is only the American group's third international amusement park and its track record is mixed. Tokyo Disneyland makes money, but Euro Disney in Paris (of which it owns 39%) nearly went bankrupt and remains heavily indebted. This time, Disney's money should be safe. The Hong Kong park is predicted to attract a healthy 5.6m visitors in its first year, with numbers rising as it taps into the growing wealth of China's middle class. Disney's financial exposure is through a joint venture with the Hong Kong government—Disney paid $314m for its 43% stake. In return it gets management fees and royalties on merchandising, food and the nearby hotels.

Hong Kong should also profit. The government has invested heavily in securing the park: granting Disney a beautiful site on Lantau island, lending construction money and laying a dedicated train line (the carriages come with Mickey-shaped windows). Some costs will be defrayed through profits on its 57% stake in the park. But the main gains will come indirectly. The new Disneyland should help almost double tourist numbers this year, according to the city's tourist authority.

To extract the most from its guests, Hong Kong Disneyland has tried to adapt to local tastes. Though its attempts to serve shark's fin soup, a local delicacy, were thwarted by Greenpeace, dim sum restaurants sit, incongruously, on the wild west-themed "Main Street, USA." Cartoon character-emblazoned merchandise comes in solid gold, and for the camera-mad Chinese there are fewer scary rides and more costumed staff scattered about for "photo-ops".

The park's layout and opening date are ruled by strict feng-shui principles, but Disney may need more than this to persuade the cost-conscious Chinese to spend. Rather than buy official photographs, they tend to snap their own, even posing with shop toys which they then do not buy. Prices at HK$295 ($38) for an adult ticket on a weekday are cheaper than at other Disney parks. But whether such concessions create enough repeat business for long-term success remains to be seen. Several visitors complained to your correspondent that the park was too Chinese—with too many shops and not enough American razzle.

Business and human rights

Rights and wrongs

Sep 8th 2005
From The Economist print edition

Big oil versus Amnesty International

ATTACKS from non-governmental organisations (NGOs) are now a standard part of big business life. This week's targets? Those favourite NGO-punchbags, international oil companies. In a new report, “Contracting Out of Human Rights”, Amnesty International has taken aim at a consortium involving two American oil giants, Exxon Mobil and Chevron, and Petronas of Malaysia, that is extracting oil in Chad and pumping it to the Cameroon coast via a 665-mile (1,070-km) pipeline.

The $4.3 billion project—the biggest ever foreign investment in Africa—has long been a cause célèbre for NGOs, fearful of its impact on one of the poorest, most ill-governed parts of the world. Oil firms have often been damned by association with human-rights abuses in similar places—not least Royal Dutch/Shell in Nigeria and Unocal in Myanmar.

Amnesty is not (yet) accusing the consortium of any specific human-rights abuses in the Chad-Cameroon project (though protesters against it have been abused in government crackdowns). Instead, its report focuses on the potential harm that may be done, as a result of the contracts governing the deal. At the heart of these contracts is a “stabilisation of law” clause, under which the consortium will be compensated for any economic harm caused to it by changes in the legal regimes governing the project.

The appeal of such a clause to the oil firms is obvious, given the long history of unscrupulous governments ripping off foreign investors. But, argues Amnesty, one effect of the clause may be to impose a financial penalty on any government that tries to improve human rights by, for example, requiring higher minimum safety standards or quicker redress for lost land.

This risk may well be overstated. Exxon and its peers insist they would not seek compensation for changes that genuinely sought to improve human rights. On the other hand, after an earlier report by Amnesty on the equally controversial Baku-Tbilisi-Ceyhan pipeline, a consortium led by BP agreed to add a “human-rights undertaking” to its contracts with the governments of Azerbaijan, Georgia and Turkey. Ideally, such undertakings will become a standard feature of contracts between international investors and governments.

The role that firms might play in advancing human rights is becoming a big issue. John Ruggie has just been appointed as the first UN special adviser on human rights and business. Activists increasingly see firms as a powerful tool for putting pressure on bad governments. And as firms in rich countries become ever keener to be known as good corporate citizens, some are seeking new international rules, not least so that they can compete on fair terms with rivals from China, which are already happily striking deals with the world's nastiest governments.

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Economist.com BUSINESS

Cricket

The benefits of Woodworm

Sep 8th 2005
From The Economist print edition

The new kid on cricket's block

Reuters

The worm turns for Flintoff

FEW sports revere tradition quite as much as cricket. When the England team took to the field to play Australia at the Oval cricket ground in London on September 8th, they were continuing a rivalry that dates back to 1877. Unsurprisingly, in a game so conscious of its own history, the commercial names that dominate the game also have venerable histories. England's two most famous brands of cricket bat are manufactured by Gray-Nicolls and Gunn & Moore, both companies that have been around for over 100 years.

But the business success story of this cricketing summer is a new kid on the block. Woodworm cricket bats have only been made for three years. But they have already captured 10% of the English market and are being used by the two most exciting players of this summer series, the big-hitting English batsmen—Andrew Flintoff and Kevin Pietersen.

Calling a company that is trying to sell sturdy products made of wood, “Woodworm”, suggests an unconventional approach to marketing. And indeed Woodworm, although a small firm, uses very modern business practices. Slow organic growth was not for the company's founder, Joe Sillett. “If this was going to happen, the brand had to have a high profile,” he says. It would be expensive and risky. So Woodworm splashed out most of its marketing budget on sponsoring Messrs Pietersen and Flintoff. The company's boldness has been repaid with good luck. This has been the most exciting “Ashes” series for many years and its two sponsored players have advertised Woodworm bats in the most effective way possible; by using them to clout the Australian bowling to spectacular effect.

Woodworm also structured its business in a modern way. It has just five employees at its headquarters in Sussex, and outsources all other activities, such as logistics and manufacturing. Its bats, for instance, are made in India mostly from English willow. By contrast Gunn & Moore still carry out all their own production in England.

Other cricket-bat makers, such as Slazenger and Puma, are international brands that make a range of sporting goods. This is where Mr Sillett is looking to take his business, perhaps by bringing in new partners and investors. The company's logo of a sharp-toothed woodworm looks like migrating from the back of cricket bats to other sporting goods, and even to other markets such as the United States. Will home runs ever be flying off a Woodworm baseball bat?

TV on mobile phones

Anyone for telly?

Sep 8th 2005
From The Economist print edition

The mobile-telecoms industry thinks it has found salvation—again

Get article background

WILL watching television on your mobile phone be the next big thing? Many in the mobile-telecoms industry think so. Nokia, the world's largest handset-maker, has just released the results of a mobile-TV trial in Helsinki which found that 41% of participants were willing to pay for the service, and thought a monthly fee of €10 ($12.50) was reasonable. The response to the trial was "exceptionally good", says Pekka Rantala of Nokia. Others in the industry are similarly optimistic. "It has tremendous appeal to consumers," says Andrew Cole of A.T. Kearney, a consultancy. Trials are under way around the world, and in South Korea a mobile-TV service launched in January has already attracted over 100,000 subscribers.

If you think all this sounds familiar, however, you are right. As revenue from voice calls has stopped growing in developed markets, the industry has been searching for new avenues for growth. In recent years it has championed mobile web-browsing, picture-messaging and video-telephony as the answer. Its latest passion, at least until mobile-TV mania broke out, was for music downloads to mobile phones—witness the fuss over this week's announcement of a music-player phone from Apple. But, despite all the hype, consumers have not taken to any of these things in large numbers: most people, it seems, are content to use phones simply for voice calls and text messages.

Hence the suspicion, among sceptics, that mobile TV is merely the latest in a long line of new services that nobody really wants, but which the industry is trying to foist on them anyway. "They are desperately trying anything," says Michelle de Lussanet of Forrester, a consultancy. Her research shows that 60% of consumers in Europe and America are not interested in watching TV on their phones.

Ah, but mobile TV is different from all those other services, say true believers, because there is no need to educate the consumer. "Everyone gets it if you say 'mobile TV'," says Richard Sharp of Nokia. Mr Cole notes that Forrester asked people whether they wanted mobile TV without actually showing it to them. "But if you've seen it, oh my goodness—the responses are off the chart," he says.

If demand is so great, why does hardly anybody use existing portable TVs, then? For a number of reasons, says Mike Short of O2, a European operator that is currently carrying out a mobile-TV trial in Oxford. Current portable TVs can only pick up terrestrial transmissions, which means there is relatively little sport, much of which has moved on to satellite and cable channels; they also have large aerials and do not work well on the move. But the various mobile-TV technologies now being tested have been optimised for mobile use. The trial in Helsinki, which was conducted with the co-operation of Finnish broadcasters, found that familiar TV shows, sport and international cable-news channels were most popular with viewers.

So perhaps there is something to the idea after all. Even sceptics such as Ms de Lussanet concede that mobile TV might prove popular—eventually. The problem is that, as usual, the industry is being far too optimistic about how quickly it can launch the service. Several operators will probably try to launch mobile-TV services next year, she says, but as with web-browsing, picture-messaging and video-telephony, the initial service will be “far from perfect”. Operators and broadcasters must strike deals, regulators must allocate spectrum, and national mobile-TV broadcasting networks will have to be built. Users will also have to upgrade to new handsets with built-in TV receivers, which will have to be easy to use and not too bulky, expensive or power-hungry. “Those things take years to come together,” says Ms de Lussanet. Then, and only then, will it be possible to tell whether mobile TV is something that people really want.

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Indian call centres

Busy signals

Sep 8th 2005 | DELHI
From The Economist print edition

Too many chiefs, not enough Indians

THE last thing you would expect India's call-centre bosses to be worrying about is a shortage of staff. The entire “business process outsourcing” (BPO) industry, including a wide range of services besides manning the telephone, employs an estimated 348,000 people (see chart). Nearly 3m English speakers graduate from university every year. That has been India's big attraction: call-centres have been spoilt for choice. Yet finding and retaining qualified workers has become the industry's biggest medium-term worry. It may, as a new report by Gartner, a consultancy, puts it “stall the offshore call-centre boom”.

The infant industry has grown explosively. Youngsters have hopped from job to job. Staff-attrition rates for the industry as a whole have climbed to 45-50% a year. Entry-level salaries have now reached about 10,000 rupees a month ($230), considered very high for a first job (which explains why outsourcing to India remains so attractive). Training costs are also mounting, as firms take on less-qualified applicants. Sam Chopra, president of the Call Centre Association of India (CCAI), which represents some 60 of India's 400-odd BPO firms, says the pressure is such that firms do not always check staff references at once. Such slipshod practices are blamed for the very few, but widely publicised, fraud scandals.

Call-centre jobs, rather glamorous until recently, are losing their allure. Staff often have to work nights, put up with abuse and undergo undignified security checks. With the number of BPO workers expected to reach 1m by 2009, a shortfall of 260,000 qualified personnel is predicted. Sujay Chohan, of Gartner, contrasts BPO with India's booming software-development industry. There, Indian firms grew in parallel with their mostly American clients. Engineering colleges, in-house trainers and private institutes kept pace with demand. In businesses such as call-centres,

however, growth is even faster and training has been much less organised.

The industry is beginning to help itself. The CCAI, with the Confederation of Indian Industry, has launched a training initiative. It will offer a standardised qualification for new BPO workers: improving English, “neutralising” accents, teaching some computer skills and so on. NASSCOM, a lobby for the software and services industry, is also introducing an “assessment and certification” programme for would-be employees. Such schemes should cut costs, ease wage pressures and help keep crooks out.

India still has a unique combination of manpower and English-language skills. But the full potential of BPO, beyond call-centres, has only been glimpsed—there are huge emerging markets in legal services, accounting, health care, personnel services, and so on. It would be a shame if India were to miss out by misusing its one unbeatable, seemingly inexhaustible resource: well-educated young people.

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European utilities

Energetic efforts

Sep 8th 2005
From The Economist print edition

The wider significance of a Spanish takeover battle

EUROPEAN integration may be politically unfashionable—but it is still happening in the business world. Take the energy market, which is set for full liberalisation by 2007. When that happens, it is widely anticipated that the European Union will move from a series of markets largely fragmented by nationality, into a genuine single market dominated by five to seven pan-European players. A flurry of consolidation is taking place, as firms position themselves to be one of those big players. The latest move took place on September 5th, when Gas Natural of Spain launched a €22.5 billion ($28.1 billion) unsolicited bid for Endesa, a Spanish electricity firm.

If it goes through, the deal would be the biggest takeover in Europe so far this year. It would also be part of a series of energy deals taking place across the continent. Also on September 5th Germany's E.ON said it was thinking about bidding for Scottish Power, a British company. Last month, France's Suez bought the 49.9% it did not already own of Electrabel, a Belgian electricity firm. And after this summer's partial privatisation of Gaz de France, the former gas monopoly, the French government is preparing the partial privatisation of Electricité de France (EDF), the former electricity monopoly.

In its quest to become one of Europe's energy giants (alongside such probable players as E.ON and EDF) Gas Natural has tried twice in the past five years to buy a big power company in its Spanish home market. Both times its bid for Iberdrola was frustrated by a combination of regulators, major shareholders and politicians.

Politicians from the centre-right Popular Party (PP), Spain's largest opposition party, are already up in arms about Gas Natural's latest move, claiming it will reduce competition in Spain's energy market. Their outrage is probably also fuelled by the fact that Endesa is a company based in Madrid with ties to the PP, while Barcelona-based Gas Natural has close links with Catalonia's regional party, a coalition partner of the Socialist Party. Spain's Socialist-led government seems unlikely to block the takeover. It is in favour of building national champions and does not want to miff an important coalition partner. The real problem could be the competition authorities. Will they accept less competition within Spain, in return for sharper competition across Europe?

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Economist.com BUSINESS

Face Value

New York's real-estate queen

Sep 8th 2005
From The Economist print edition

At the top of the market with Dolly Lenz

AT $31.5m for 500 square metres of living space, the penthouse at 502 Park Avenue is a pricey bit of property even by the exalted standards of Manhattan. But what the heck. It has two terraces overlooking Central Park, you can see for miles, and when Dolly Lenz is showing it the view in every direction is one of boundless optimism. Let others manage without a 42-windowed Italianate drawing room, a heart-shaped double staircase, white-oak floors sawn from trees personally selected in the Allegheny mountains by Donald Trump Jr and a choice of three elevators—one for the servants, one that you share with the other billionaires in the building and one that is yours alone. But you deserve these things, and to get them you go to Ms Lenz, the top real-estate agent in a city that is obsessed by real estate to the point of derangement.

The average selling price of all apartments in Manhattan passed $1m last year, and is now around $1.3m. At the top end of the market, where Ms Lenz and three or four rivals hold sway, the surge has been more spectacular still—or alarming, if you happen to be out of the market. Apartments with four bedrooms or more, the sort of thing found mainly on the posh Upper East Side or Upper West Side of the city, more than doubled in price between the second quarter of last year and the second quarter of this year, according to Miller Samuel, a property-valuation firm. Across the United States, house prices have been rising at their fastest rate in 26 years, thanks to cheap mortgages (see article). The willingness of homeowners to borrow and spend against this paper wealth has helped America's economy to go on growing briskly, at least until now, despite rising interest rates and record-high petrol prices.

Ms Lenz is an engagingly chatty and precise New Yorker of 47, an accountant by training, born with a Blackberry in one hand and a Chanel bag in the other. She reckons to have sold more than

$4 billion worth of property in her 20-year career, and to be selling now at the rate of $400m-450m a year. Her firm, Prudential Douglas Elliman, part of the Prudential Real Estate network, vies for leadership of the Manhattan market with Corcoran, part of the Cendant group. Steven Gaines, author of “The Sky's the Limit”, a gossipy new history of the New York property market, calls her “a powerhouse that no one [can] touch”. She sold almost $400m worth of apartments in the Time Warner Centre on Columbus Circle, which opened last year, and where record prices pushed up the whole top end of the market. Late last year she sold an estate on Long Island for $45m, the highest price ever paid for a New York residence.

Ms Lenz credits the current boom to a mood swing among the rich after the attacks on the World Trade Centre four years ago this week. The market sagged briefly along with the rest of the local economy, she says, but then came roaring back, especially at the top end, when people with money decided that they should enjoy life while it lasted, and that if New York could survive 9/11, it could survive anything.

Another big change in the market, says Ms Lenz, has been the arrival of the “hedge-fund guys”. Fifteen years ago she was selling to doctors and lawyers as well as bankers, most of them wanting an eight-room apartment for life somewhere on the Upper East Side. Now, along with international investors and a few celebrities, her biggest customers are hedge-fund managers and other Wall Street lions who expect to change properties after two or three years like other people change cars. She tells of one hedge-fund manager, 33 years old, who bought a $24m apartment in an hour, explaining that he had “just bought a $19m painting at Christie's, and he was not going to put it up on a $2m wall”. The potential buyers for the Park Avenue penthouse include another “hedge-fund guy” she says, and a “royal-family-type person”.

The view from the top

The developer at Park Avenue, Donald Trump, whose grandiose buildings bestride New York, has played a big part in Ms Lenz's success. He backed a road show that she took to Hong Kong in 1991, selling apartments in an earlier Trump building. She found that Asia's new rich would buy four or five New York apartments at a time, for investment, much as they did with property at home, and she was happy to oblige. Bulk buyers—many from overseas—now make up roughly half her business, usually seeking condominium apartments that they can buy outright. The collectively-owned “co-op” apartment buildings more common in New York are prone to reject absentee landlords as buyers, and anybody else who might ruffle their composure. A few years ago Ms Lenz sold Barbara Streisand's apartment on Central Park West to Mariah Carey, another popular singer, only to have the deal blocked by a residents' committee which balked at the team of bodyguards accompanying Ms Carey to her interview.

Ms Lenz sounds as bullish as you might expect when she talks of the prospects for the New York market now. She sees some froth, but no bubble. Another point on interest rates is not going to worry many of her buyers, she says, although a crisis in the hedge-fund industry would certainly hurt. With so much money heading downtown into loft conversions in Chelsea and Tribeca, she says, the Upper East Side is even looking relatively cheap these days. It is all a matter of supply and demand, and she sees the right amount of both.

She may be right. And yet when a particularly grand townhouse on Fifth Avenue is on the market for $50m, and when every able-bodied New Yorker seems to be retraining as a real-estate agent in the hope of emulating Ms Lenz, it is hard to avoid the sense of a market at its peak. The view from the penthouse at 502 Park Avenue is indeed spectacular, but it is a long way down.

Economist.com BUSINESS

The global car industry

Extinction of the predator

Sep 8th 2005
From The Economist print edition

How merger mania has been a disaster for the world's great car manufacturers

THE star of the huge Frankfurt Motor Show, which opens on September 12th, may well be the latest luxury Mercedes-Benz S-class, the model on which the German company is relying to repair its faded reputation for superior quality. But the more significant event at the show will be the presence on display for the first time of three different vehicles made in China by local firms and destined for export. Already the first Chinese cars for Europe's roads are being unloaded in Rotterdam. Plans are well under way for Chinese models to be sold in America as well.

Today's controversies over high petrol prices and fuel-guzzling SUVs in the huge American market offer only a partial picture of the future facing the industry as a whole. It may well be fully mature in markets such as North America, Europe and Japan, where over-capacity continues to sap profitability. But globally the industry is set for huge expansion with the motorisation of China and India. Within a few years China will replace Japan as the second-largest national market after America. Some experts predict that over the next 20 years more cars will be made than in the entire 110-year history of the industry.

Garel Rhys, director of the Centre for Automotive Industry Research at Cardiff University in Britain, says this growth will create the need for 180 new factories, each producing 300,000 cars (and light trucks) a year—in effect, almost doubling the production capacity of the global industry to over 110m units annually. Today's car plants, he says, will need to be “renewed, retooled, refurbished and replaced to remain competitive. There is nowhere for the inefficient to hide.”

That is a bleak message for today's established big producers, many of which have merged their way to giant status, but remain chronically hampered by legacy costs and operating problems and

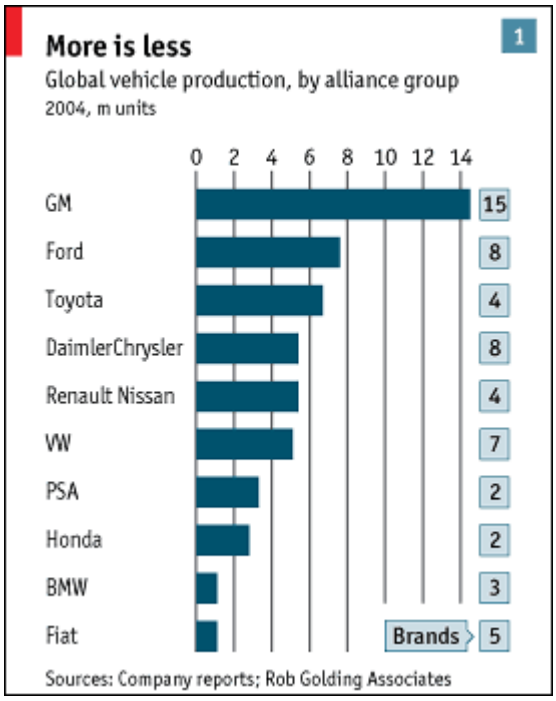
could now be beaten by new entrants and competitors that have eschewed the merger game. The new car industries springing up in China and India will account for most of tomorrow's extra production. As their output starts to reach markets around the world, the question is: which of today's big carmakers will be hurt the most? Eventually the question could be an even tougher one: which will survive?

Other industries subjected to similar waves of new competition have seen dramatic shake-ups and the disappearance of famous names—personal computers offer a good example. Imagine General Motors (GM) stopping making Cadillacs and Chevrolets to concentrate only on SUVs and developing technology for others to use to make cars. Some observers predict just that: famous carmakers will own the technology and brands, while manufacture and distribution will be contracted out to parts-makers or general engineering manufacturers. (This already happens with a few low-volume cars, such as the Porsche Boxster.)

Consolidation in the car industry has been going on since its earliest days when 200 garage-sized firms were bundled into GM. By the middle of the last century such famous names in America as Studebaker and American Motors were closing down or being gobbled up by stronger companies, leaving the industry in the hands of GM, Ford and Chrysler. In Europe, virtually the entire British car industry was rolled into British Leyland, which was the third-biggest manufacturer in the world at its creation in the 1970s. In France, Citroën was swallowed by Peugeot, though the brand survives, while Simca went into the maw of Chrysler, never to be seen again.

Consolidation in cars is not as starkly obvious to the consumer as it has been in, say, personal computers. A plethora of badges still remains, as mergers and alliances between firms over the years have simply bundled, rather than destroyed, brands. No fewer than 58 brands survive among the ten largest manufacturers. In fact, if their affiliates as well as their wholly-owned companies are counted, the top five company alliances account for 75% of the global market, while adding the next five takes this to 90%, with producers in China, India and Malaysia making up the rest.

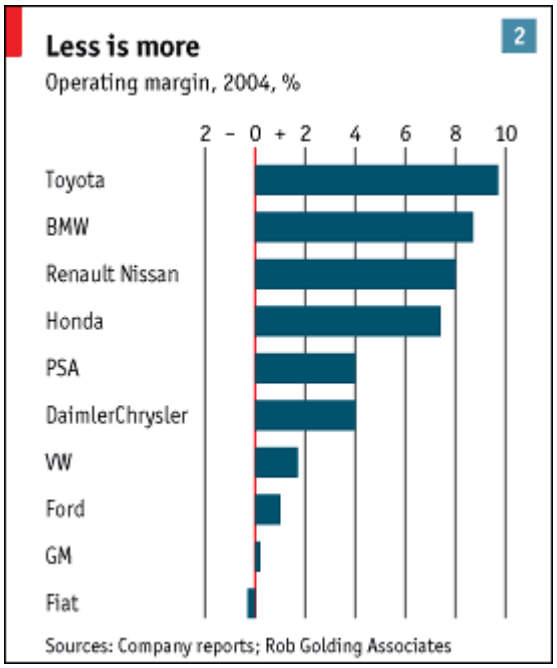
The strategy of consolidating behind the brands has not been entirely successful: indeed there is an inverse correlation between the number of brands a firm possesses and profitability. GM may still be the big beast of the industry, but it is no longer in any shape to gobble up others. It has twice the number of brands of its closest competitor, Ford, but is second to last in the profitability league (see the charts). The same goes for Ford, whose annexation of Mazda and Volvo keeps it just ahead of Toyota in terms of production. Toyota, the industry's profitability champion, has only four brands and a handful of models, but a huge range of variants on them.



The industry has experienced a 20-year splurge that has seen, for instance, GM swallow Saab and Daewoo, while signing up Isuzu, Subaru and Suzuki in Japan, taking key stakes in them in order to share their small-car expertise and gain access to the Asian market. Since 1989 Ford, the next biggest brand-acquirer, has taken over Jaguar, Aston Martin, Land Rover and Volvo, while it has also bought heavily into Mazda. But it, like GM, has done more spending than getting. Jaguar still bleeds cash after an investment topping $5 billion and Volvo has only recently scraped into profit. None of this has done anything for the company's profitability, leaving it languishing just above GM and feeble Fiat.

Seduced by scale

The two biggest consolidation deals in the industry are also the most recent: the takeover of Chrysler by Daimler-Benz in 1998; and the alliance of Renault and Nissan the following year. DaimlerChrysler has been a flop so far. It has taken years to lick Chrysler into shape, slashing its surplus capacity and reviving the brand with new products good enough to drag it back into profit this year. Meanwhile, top management attention was diverted from growing problems at home as quality slid at Mercedes, which lost its long-standing dominance of the lucrative German market to its arch-rival BMW.



The best justification for the Daimler-Chrysler deal, at the time the world's biggest industrial merger, was the growing cost of electronics systems in luxury cars. Mercedes was the world leader in such sophisticated electronics, but it was not a volume car producer, which meant it laboured with a higher cost base. Daimler's hope was that, by buying Chrysler, it could enter the volume end of the car market in one step, and so spread the costs of new technology over a much bigger output. German rigour was supposed to produce rewards in the world's biggest and (for good manufacturers such as Toyota, Nissan and Honda) most profitable market.

It did not work out that way. Daimler and Chrysler together are worth less in stockmarket terms than Daimler alone was before the merger. This summer the architect of the deal, Jürgen Schrempp, was nudged out of his chief executive's chair (he leaves at the end of this year) by leading shareholders as a result.

The deal between Renault and Nissan was a bold move by the French company to gain global scale. Having put its house in order at home, the privatised French company saw its market capitalisation rise as that of loss-making Nissan slipped. So Renault's then chief executive (now chairman) Louis Schweitzer pounced on the opportunity to give Renault global reach and scale. He made the Japanese a friendly offer. But he was cautious enough to take at first only a controlling 37% stake.

The French later increased their holding to 44%, as Nissan's industrial debt was cut by profits and by disposal of the firm's outdated *keiretsu* equity stakes in its suppliers. The deal has paid off as well as the German-American one has flopped. Indeed, Nissan's earnings have been propping up Renault, as the latter has gone through a lean period in the past couple of years, hemmed in by an ageing model range and stagnant markets.

So there are several reasons for the end of takeover activity: the binges of the past have left the predators with, at best, no appetite for more or, at worst, severe indigestion. Moreover, what is left amounts to slim pickings, as GM found when it decided to pay $2 billion merely to go back on a hastily made promise to buy troubled Fiat, after five years of collaboration had shown the Detroit firm how weak its Italian partner was. GM has evident problems of its own—notably the rocketing cost of pensions, health care, lay-off pay and the need to rescue near-bankrupt suppliers. Nevertheless, this surreal episode was a seminal moment. Once the very fact that

brands with the glamour of Ferrari, Alfa-Romeo and Maserati were available would have produced a scramble among potential buyers. Fiat's financial difficulties would have been regarded as an opportunity for the predator, not a threat. Today no one wants to take them on.

Nor are the new producers in emerging markets in any position to go on a buying spree. Korea is down to one manufacturer, Hyundai, from the seven it had 20 years ago. China has two dozen established vehicle-builders and start-ups, which will have to go through the normal 10-15-year process of consolidation before one group can emerge that is large enough to gobble up substantial competitors. The very fact that SAIC and Nanjing Automobile sniffed at the remains of Britain's MG Rover and then backed away shows that they are far from ready to take on a living enterprise.

The brand news

The lesson of two decades of frantic mergers and acquisitions in the motor industry is that acquired brands, however strong and attractive they might appear, take years to restore. They first need cleaning up, then bending to the shape and behaviour of the new family. And they need to be fitted out with new products worthy of the badge on the front (Jaguar is the clearest example of this).

GM's unhappy cohabitation with Fiat was concurrent with its ownership of Saab, which it bought as a consolation prize when it was beaten to Jaguar by Ford. Fifteen years later that, too, looks like a mistake. Last year a review was started that ruled nothing out—sale and closure included. A frantic programme is under way to reduce costs through platform and component savings with other members of the GM alliance group, including Subaru and Chevrolet. But using the corporate parts bin is a quick way to cheapen a brand.

And then there is Volkswagen, pride of the European predators. It used acquisitions to expand geographically—first southwards to pluck SEAT in Spain, then eastwards to take over Skoda in the Czech Republic. In parallel with a masterful 20-year rehabilitation of Audi as a prestige brand, VW also snapped up Bentley, Bugatti and Lamborghini from their distressed owners.

Bentley has been a fabulous success with queues of keen buyers for its Continental coupé. Lamborghini has a couple of new Batmobile-type street racers that look good but have not yet turned a profit. Critics want to know how VW will redeem the muddle of Volkswagen, SEAT and Skoda brands all scrapping for the middle market and competing with each other, and what it can do to recover from the recent slide in its share of the American market, where only a few years ago it was zooming ahead. Job cuts in Germany mooted this week, maybe up to 10,000 of them, will not begin to address that problem, but might provoke damaging strikes.

In-breeding as a virtue

The most sensible of the carmakers has spurned the consolidation game. Toyota is still not the world's largest by number of cars built, but given the speed at which it is growing (output has expanded by 1.5m vehicles in the past five years, half the total growth in world production) and the speed at which GM is shrinking, the day when Toyota becomes the biggest is probably no more than five years away. Investors already recognise it as the leader. Its market capitalisation, at $150 billion, is greater than that of GM, Ford and DaimlerChrysler combined ($90 billion).

This superiority has been achieved by concentrating on organic growth. Apart from scooping up Daihatsu to get small-car engineering and engines years ago, Toyota has concentrated solely on

improving its own offering, with a relentless focus on efficiency, cost-cutting and a flood of new variations of successful models brought to market at an increasingly rapid rate.

Toyota's luxury car business, Lexus, was created from scratch, rather than by the purchase of some other firm's famous, but tired, brand. Lexus is now the best-selling prestige brand in America. Encouraged, Toyota is spending lavishly this year on marketing it in Europe and Japan as well.

People scoffed when Toyota announced its plans for creating its own luxury brand rather than paying for some other firm's glorious history. But Lexus has been spared all the tears, toil and sweat associated with a takeover. And it has succeeded by following a policy that many makers seem to find hard to copy: give people cars that don't break and treat customers like royalty.

Buying brands and additional international reach have been the strategies behind many takeovers. But so too was the aspiration of using volume to achieve economies of scale. Analysts are no longer sure, however, that there is any great merit in that. Keith Hayes of Goldman Sachs reckons that 500,000 copies off a single platform is about the point at which scale benefits start to drop away. Besides, there are many things more important for the big firms to concentrate on.

In the past, making large numbers of a few models was the way to thrive. Now it is all about making a few copies of a lot of derivatives. Look at the dozens of model categories in today's Mercedes and BMW ranges—a few years ago they had just three each. Yet total sales of each brand are still only around 1m. Creating niches from common platforms is the new way to compete. BMW now sees strong competitive advantage in maintaining differences between all the cars it sells. It is investing in infrastructure so that customers can change the specification of their car as late as 100 hours before it is built. That encourages customers to spend more on optional equipment. For the carmaker it also means that every assembly plant has to be surrounded by its own suppliers. An engine cannot be shipped across continents within 100 hours of a request. Separate factories allow for more variation, but at the price of fewer economies of scale. However, the greater the specification by consumers, the higher the premium price the carmaker can command.

In addition, there are more cost savings available from cutting warranty and recall costs than from maintaining a large degree of commonality among various models. And for many of the big groups—especially the Japanese—there are massive savings to be had from dealing with white-collar inefficiencies. All of these productivity gains can now be achieved without large scale or the headaches of an acquisition.

The obvious conclusion might be that the 100-year-old car industry has done its rationalisation and consolidation and that what remains must therefore be leaner and fitter. It should be, but it isn't. John Murray, chair in Business Studies at Trinity College Dublin, points to a worrying loss of power by the carmakers, rather than the expected gain. The makers have pushed much of their intellectual property away to the first tier of component suppliers, which have taken physical assets along with the necessary skills. And downstream, the new multi-brand retailers and the internet-savvy consumers are together gaining power and a bigger chunk of the value chain. The so-called car manufacturers are going to be left to take care of just design, marketing and brands—a long way from the traditional skill of managing big manufacturing businesses.

The car industry could probably now cope with an implosion of the assemblers, thinks Mr Murray. “An alliance of Tier One component integrators and the new major retailers could happily fill the vacuum.” That is a radical and visionary thought. But at the moment the big component providers are scarcely in the shape to do anything. Delphi, the world's largest, recently considered bankruptcy as one of the solutions to its huge financial problems.

Good in parts

Dizzying price increases lately for raw materials have neatly sorted the sheep from goats. Some suppliers told auto clients that they needed a price increase to compensate and were told to go home and have a long think about it. Others came up with the same speech and got what they wanted because the carmakers needed what was being offered at any price. Saul Rubin, specialist autos fund manager at Rockhampton Management, says that the episode highlighted the quality players. Some suppliers, such as Magna, are frank about the eventual need to have their own final assembly capacity. Non-unionised component companies in America cannot wait to buy a redundant assembly hall after a bankruptcy at GM. That is an investment trend to look out for.

Then, of course, there is just a chance that GM will not implode and instead will become the next Nissan. Implausible recovery stories (Chrysler twice, VW, Renault, Porsche, Nissan) have cropped up every decade and have paid returns far greater than any takeover bid ever did. More likely is that GM, like many of its established big rivals, will go on struggling with the consequences of the industry's consolidation to date. In future, as the global industry expands, new names will join those of Toyota and a few others. Yesterday's predators, obsessed by their takeovers and mergers, will give way to nimbler, smarter carmakers that will reshape the global industry.

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Economist.com FINANCE & ECONOMICS

The UN's Millennium Development Goals

Aspirations and obligations

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Reuters

The Millennium Development Goals cannot be met; some can barely be measured. What, then, are they for?

JOHN BOLTON, who recently became America's representative to the United Nations, is not over-fond of his new place of work. He belongs to the school of thought that sees the UN not as a temple to international co-operation but as a polyglot talking shop, with exorbitant Manhattan parking privileges.

“The currency of pledges from the international community is by now so severely debased by non-delivery that it is widely perceived as worthless.” That is the kind of sentiment one might associate with George Bush's man in New York, but those are not his words. Surprisingly, perhaps, they come instead from the latest Human Development Report, just published by the United Nations Development Programme.

The report appeared a week before the UN's big summit in New York on September 14th-16th, and five years after world leaders minted a new set of pledges to free their fellow man from “the abject and dehumanising conditions” of extreme poverty. The pledges were translated into eight “Millennium Development Goals” (MDGs), which aim to halve poverty and hunger, enrol every child in primary school, spare mothers and their infants from untimely deaths, thwart infectious diseases, save the environment and forge a “global partnership” in pursuit of development. The first MDG—cutting extreme poverty to half its 1990 level by 2015—may well be met in global terms, the Human Development Report says. But there the good news ends. On present trends, the report concludes, most poor countries will miss almost all the goals, in some cases by “epic

margins" (see table). Extreme poverty, for example, will not be halved in any region except East Asia. The report calculates that by 2015 380m poverty-stricken people, most of them Africans, will remain in the condition from which the UN's members promised to liberate them.

If the value of such pledges is debased, how should the world respond? One way to restore the value of a currency is to back it with something tangible. This is what the Human Development Report proposes. It says that rich countries should offer more aid to poor ones (see article) and less to their own farmers. It also urges governments in poor countries to tackle the inequalities within their own societies. Only 40% of Pakistan's primary-school pupils are girls, for example.

But another way to restore the value of a currency is to restrict its supply. This is the route Mr Bolton seems to prefer. In recent weeks he has proposed excising all mention of the MDGs from the final declaration, removing from circulation the pledges the Human Development Report fears are now perceived as worthless.

Goal difference

Selected Millennium Development Goals

Indicator, m	2002	2015*	Goal for 2015	Projected shortfall
Deaths before fifth birthday	10.5†	8.6	4.2	4.4
People without access to clean water	1,036.6	525.2	315.3	209.9
People living on less than $1 a day	1,072.0	826.7	446.8	379.9
Children not enrolled in school	109.9	46.7	nil	46.7

Source: UNDP *At current trend †2003

Mr Bolton's editing provoked dismay. On August 26th, he wrote to his peers at the UN "to eliminate any possible misunderstanding". America supports the development goals of the Millennium Declaration, he insisted, but it does not support the Millennium Development Goals. Confused? Mr Bolton explains that America signed up to the goals expressed in the 2000 Millennium Declaration—which include most of the headline targets such as halving poverty and hunger by 2015, promoting universal primary schooling, and cutting child mortality by two-thirds—but not to the full panoply of indicators and schedules formulated by the UN secretariat the following year.

The chief appeal of the MDGs is precisely that they convert high rhetoric into hard numbers. But most of the targets are less rigorous than they look. There is, for example, no way of knowing whether several of them are being met or not. In a forthcoming paper in *Public Library of Science Medicine*, an academic journal, Amir Attaran of the University of Ottawa points out that only one African country (Mauritius) registers births and deaths according to UN standards, and that no country regularly measures how many people are newly infected by tuberculosis. In July 2000, he says, a scientist concluded that it was not possible, in general, to measure the number of new cases of malaria. These shortcomings will prove increasingly embarrassing to the UN, Mr Attaran predicts. As 2015 approaches, people will want to know whether the MDGs have been met, and the UN will not be able to tell them. Indeed, the UN is already quite defensive. Mr Attaran quotes a UN memo, circulated a year ago, which cautioned that next week's summit "should not be distracted by arguments over the measurement of the MDGs".

One target that can be measured is the 0.7% of GDP which rich countries are supposed to devote

to foreign aid. Many donors have promised “efforts” to reach the target, but only five have met it. Mr Bolton does not intend even to try. “The United States has consistently opposed numerical aid targets from their inception in the 1970s,” he wrote to his UN colleagues.

But Jeffrey Sachs, the economist who is the MDGs' chief intellectual sponsor, thinks the 0.7% target now has more than history to recommend it. Suppose, he says, we gave the money needed to reach the poverty line to everyone below it. How much would it take?

Martin Ravallion and his colleagues at the World Bank put the international poverty line at $1.08 per day, measured in 1993 purchasing-power parity dollars. They estimate that in 2001, 1.1 billion people fell short of this line, by $113 on average. Giving $113 a year to 1.1 billion people would cost $124 billion. As Mr Sachs points out, this is little more than 0.6% of the combined GDP of the OECD's 22 donor countries, measured in the same purchasing-power parity dollars. Thus the promise to devote 0.7% of GDP to fighting poverty has a theoretical rationale today that it did not have when first proposed in 1970. With an aid budget that size, the “poverty gap” could in principle be filled.

Mr Sachs's thought-experiment is intended as no more than an “eye-opening” illustration. But it is nonetheless misleading, argues Surjit Bhalla, a former World Bank economist who now runs Oxus Fund Management, a hedge fund. As Mr Bhalla points out, the “dollars” used when measuring poverty around the world are not the dollars given in aid. The first is a unit of purchasing power. The second is a unit of currency, which has varying purchasing power depending on where it is spent and what it is spent on. As Mr Bhalla points out, a dollar earned in America buys much more in Ethiopia or India than in Japan or America itself.

So how many dollars would have filled the poverty gap in 2001? Not $124 billion, Mr Bhalla reckons, but only $25.1 billion. In fact the rich world gave more than $46 billion in aid that year, and has been giving more than enough to fill the poverty gap in almost every year since 1990.

Unfortunately, a victory over poverty cannot be so easily purchased. The rich world cannot pour a given amount of money into one end of an MDG pipeline and expect to see, emerging from the other, a predictable number of people freed from destitution and disease.

The global targets the world set for itself five years ago did not emerge from the bottom up, as the sum of what might be feasible in each poor country. They were instead imposed from the top down. Their fit is thus often rather awkward. Thanks to its rapid economic growth, China has already met the goal of halving poverty, more than a decade early, while sub-Saharan Africa is likely to be generations late. Of course, ambition is a good thing if it encourages countries, rich and poor, to redouble their efforts. But in Africa's case, efforts must be quadrupled or quintupled. That is a promise the international community cannot possibly keep, and so was perhaps unwise to make.

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Economist.com FINANCE & ECONOMICS

Japan's banks

Genesis

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At last, Japan's banks are creating credit

Get article background

WHEN the road is long and hard and the scenery rarely changes, weary travellers welcome any hint that they are heading in the right direction. So investors took heart on September 8th, when the Bank of Japan (BoJ) reported monthly data on lending by the country's banks. The difference between outstanding loans at the end of August and those of a year earlier was a mere 0.2%, after adjusting for securitisations and debt write-offs. But it was positive, praise be, for the first time in the seven years that the BoJ has tracked it. At long last, banks are creating credit again.

Since the previous month's figures indicated that this milestone was near, bank shares have risen by 14%—nearly twice as much as the stockmarket as a whole. Granted, banks will have to lend a lot more before credit truly reflates the economy, and interest margins will have to fatten before they make much money from loans. But they have come a long way.

The banks' slow recovery is happening in stages. First came a dramatic reduction of their bad loans. In the three years to this March, the biggest banks' non-performing loans fell from 8.4% of their total to below 3%, even though stricter inspections have made it harder to pretend that their duff borrowers are likely to repay. Although some of the credit for this belongs to the government, the main reason for the fall in the bad-loan ratio has been a rise in corporate profits.

Beginning with a boom in exports to China, and helped by earlier cost cuts, profits at Japanese companies have soared since late 2002. This profit growth started at big manufacturers before spreading to small ones and, more recently, to many non-manufacturing firms. As a result, many

loans that looked unpayable when the borrowers were losing money can now be upgraded.

This has been a great help to the banks, enabling them to reduce their bad loans and still rebuild their capital ratios, and thus giving them greater freedom. When they were undercapitalised the banks could not afford to write off bad loans, because doing so would have eaten into their capital, so they lent good money after bad to cover up the weakness of their borrowers. Now they are much freer to lend to whichever willing borrowers they choose.

Unfortunately, the second stage of recovery—the search for those willing borrowers—has been hampered by weak demand for credit. Having shed their old debts, many of Japan's biggest borrowers are loth to take on new ones. Higher profits make it easier for them to invest using their own resources. When they do want to borrow they have easy access to corporate-bond markets, where money is cheap.

Japan's banks have thus been scrambling to find new types of borrowers. High on the list are consumers and small firms. Mortgages have been growing nicely: the government decided to get its Housing Loan Corporation out of the business, and private banks have been rushing to fill the gap. Small companies are trickier, but Ned Akov, a bank analyst at Macquarie Research in Tokyo, reckons that net lending to small firms will grow over the next year.

Even if lending continues to grow, the banks' profits will not improve much until Japan enters a third stage: rising interest rates. With official rates still almost zero, the banks' net interest margins are still languishing, at 1.2%. Forward interest rates suggest that financial markets now expect the BoJ to raise rates by a quarter of a percentage point in the second half of 2006, perhaps six to nine months after consumer prices are forecast to start rising again. The banks' lending margins will not widen meaningfully, however, until interest rates are even higher: the markets do not expect rates to increase by a full point for several years.

What matters most now, however, is that Japan's slow-motion recovery continues. Should high oil prices, say, or a global slowdown knock the economy back before domestic demand recovers more fully, its brief genesis could yet give way to another investor exodus.

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Global house prices

A home-grown problem

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From The Economist print edition

America's housing boom is causing an enormous misallocation of resources

***The Economist*'s house-price indices**

% change:

	on a year earlier		
	Q2 2005*	Q2 2004	1997-2005
Hong Kong	22.1	29.1	-44
South Africa	21.4	38.2	263
France	14.5	14.9	93
New Zealand	14.2	22.3	74
Spain	13.7	17.4	171
United States	13.4	10.0	79
Denmark	12.2	7.9	63
Belgium	9.4	9.9	71
Italy	8.5	10.8	76
Sweden	8.3	9.7	84
China	8.0	10.4	na
Ireland	6.2	11.9	196
Canada	4.3	7.0	48
Netherlands	4.2	3.9	82
Singapore	2.4	-0.8	na
Britain	2.3	19.4	155
Switzerland	0.5	2.1	11
Australia	-0.1	12.7	113
Germany	-1.3†	-0.8†	*nil*
Japan	-5.4	-6.4	-28

*Or latest †2004 average ‡2003 average

Sources: ABSA; Bulwien; ESRI; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quotable Value; Stadim; Swiss National Bank; government offices

THE past few years have seen simultaneous housing booms in an unusually large number of countries. However, according to *The Economist*'s global house-price indices, in the second quarter of this year the pace of increase slowed in most places, compared with a year ago (see table). In only two of the 20 countries covered have prices accelerated significantly this year: the United States and Denmark.

The sharpest drop in annual house-price inflation over the past year has been in Britain (from 19% to 2%). Australia, New Zealand and South Africa have also seen a marked slowdown: Australian prices have even fallen, if only by 0.1%. Housing markets in Spain, France, Italy and

Ireland have also cooled a bit.

By contrast, America's housing market remains red hot. Average home prices jumped by 13.4% in the year to the second quarter, the biggest rise in 26 years—in real terms, the biggest on record. Prices are now rising at a double-digit pace in 24 states, plus Washington, DC. Seven states and the capital enjoyed gains of more than 20%.

Even Alan Greenspan, the chairman of the Federal Reserve, now seems to agree that American homes look overvalued and that there is a risk that prices could fall. A common counter-claim is that house prices are sticky downwards: the national average has never fallen year-on-year. But declines are far from rare in many parts of the country. Richard DeKaser, the chief economist at National City, a Cleveland bank, has found that in the past 20 years as many as 63 out of 299 metropolitan areas studied have seen house prices fall by 10% or more over periods of at least two years. The median decline during these slumps was 17%. This is the first time that booms—and hence potential busts—have occurred in so many states at once.

The popular argument that high house prices are justified by low interest rates has also been stretched to its limit. The affordability of houses for first-time buyers, measured by the ratio of median income to median mortgage payments, is at its most daunting since 1989—the market's previous peak, after which average nationwide home prices failed to keep pace with inflation for five years.

On the surface, America's housing boom looks more modest than those elsewhere. Since 1997 prices have risen by only half as much as in Britain. On the other hand, the property boom has probably caused a bigger misallocation of resources in America because of the response of borrowers, savers and investors. Residential investment has risen to 6% of GDP, close to a record. Add in the wealth effect from rising home values and the boost to spending from mortgage-equity withdrawal, and housing accounted for an astonishing 50% of GDP growth in the first half of this year, reckons David Rosenberg, chief economist at Merrill Lynch. Since 2001 more than half of all private-sector jobs created have been in housing-related industries.

Second-quarter figures, due later this month, are likely to show that the value of property rose to 33% of households' total assets—the highest in the 60 years for which data exist. Banks' profits have also been unduly dependent on mortgage lending. According to the Bank Credit Analyst, a Canadian research firm, property loans now account for 53% of banks' total lending, up from 30% two decades ago.

The American economy's addiction to housing leaves it exposed not only to a cooling of property prices, but also to long-term costs. The technology bubble in the late 1990s at least left behind a modern capital stock, which continues to yield productivity gains; a property boom, in contrast, does nothing to boost long-term growth. Instead, it diverts resources away from more productive sectors and by fuelling consumer spending it exacerbates America's economic imbalances. Eventually, there will be a price to pay.

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Economist.com FINANCE & ECONOMICS

Swiss private banks

Bullish Baer

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Julius Baer's expansion is only a temporary solution for its problems

EARLIER this year some 40 members of the Baer family, founding clan of Julius Baer, a Swiss private bank, had a big disagreement. On one side were those who believed that the 115-year-old family firm could no longer compete against the titans of global banking, and should be sold. The other faction, led by Raymond Baer, chairman of the bank, wanted to remain independent. The go-it-alone group won the day. Michael Baer, head of private banking and the main proponent of a sale, left the firm in early summer.

Now Raymond Baer has taken a big step forward in his effort to keep the bank independent. On September 5th Julius Baer said that it would pay UBS, a global bank based in Zurich, SFr5.6 billion ($4.5 billion) in cash and shares for three private banks and GAM, an investment firm. UBS will own 21.5% of Julius Baer. The deal will more than double Julius Baer's assets under management, to SFr270 billion, and make it by far the largest of Switzerland's independent private banks.

Even so, the bank's purchase will not solve a basic problem: it has precious little in Asia and other areas of high growth for private wealth management. Its new acquisitions all operate in different regions of the stagnating home market: Ehinger & Armand von Ernst in German-speaking Zurich; Ferrier Lullin in Francophone Geneva; and Banco di Lugano in the capital of the Italian-speaking Ticino canton.

“Baer is only putting off addressing the strategic question of an international network,” says Ray Soudah of Millenium Associates, an investment-banking boutique. Although Julius Baer does say that it is planning to open marketing offices in central and eastern Europe and in Latin America, and to make better use of its existing branch in Dubai and Banco di Lugano's tiny office in Singapore, Mr Soudah thinks that these moves and UBS's stake will deter a takeover attempt by a big international bank only for a couple of years. Ultimately Julius Baer will need a proper global network to attract decent amounts of new money.

Julius Baer is not alone. Much the same could be said about many of Switzerland's 350 or so private banks. Although the country is still host to about one-third of the world's offshore assets, its attraction as a private-banking centre has dwindled. It ceased to be a tax-free haven for citizens of European Union countries in July, when a withholding tax (imposed at source on interest) was levied on their money. Tax amnesties in Italy, Germany and Belgium led to the repatriation of lots of cash. And banking secrecy is crumbling under international organisations' pressure to help in the battle against money laundering.

The question now is whether an independent Julius Baer can grow rapidly and become more international. Maybe: analysts at Merrill Lynch regard its new management team “very positively”. Hans de Gier, a former UBS man, will be chief executive; David Solo, head of GAM, will run the fund-management division; and Alex Widmer, recently named chief executive of Julius Baer, will run private banking. Yet even a top team may find the gap between the biggest private banks and the global giants is unbridgeable.

Economist.com FINANCE & ECONOMICS

Hedge funds

In the garden of good and evil

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A spectacular story raises a simple question: why don't investors in hedge funds take more care?

IT HAS all the ingredients of an airport best-seller: fast-talking salesmen, gullible rich folk, millions of dollars kited around the world, a humble whistle-blower—even a purported suicide note. The complaint filed against Bayou Management on September 1st by American federal prosecutors alleges fraud and seeks to return what cash can be recovered to investors in this troubled group of hedge funds. This is only the latest twist in a complicated saga.

Bayou's boss, Samuel Israel III, promised exceptional returns from rapid-trading techniques, deployed mainly in both buying equities and selling them short, when he opened the first funds in 1997. By 1998 Bayou was already lying about its results, allege federal gumshoes.

In 2004, perhaps trying to shore up the funds' assets, Mr Israel consigned a chunk of investors' money to private-placement programmes that were supposed to produce returns of up to 100% a week. In a flurry of intercontinental bank transfers, one, for $100m, was flagged by a bank employee and bagged by Arizona prosecutors this May. That may be all that is now left of the $440m in assets that Bayou claimed earlier this year.

In July, Mr Israel told investors that he was winding up the funds and would return their money. In August one of them went to the fund's office to demand his cash and found instead a suicide note written by Bayou's chief financial officer (who, fortunately, is still with us), detailing wrongdoing. Various investors and the federal government are now suing Bayou.

Bayou's troubles concern its investors the most, but they also highlight a wider problem. Because lightly regulated hedge funds don't publish much information, a fund can go off the rails for a while undetected. And because hedge-fund strategies usually sound like rocket science, investors may suspend their own critical faculties, relying excessively on a fund's reputation and on outside advice.

Still, a minimum of due diligence should have raised questions about Bayou, which had had a couple of brushes with regulators. And financially, “this fund was an outlier on any chart you can imagine,” says Michael Markov of Markov Processes, who has developed software to analyse hedge-fund performance. Comparing Bayou's performance with those of other similar funds and strategies showed anomalies, he says. Bayou did not report the very highest returns but it did show by far the lowest volatility, or risk. Its returns rose smoothly each month, while those of its competitors did not. It didn't add up.

To folk who want to invest in hedge funds, as well as those who want to invest like hedge funds, Markov Processes has a lot to offer. Its founder emigrated from the Soviet Union in 1989, an ace in mathematics and programming. In New York, he wrote software by day and at night studied finance at “Barnes & Noble University”, the textbook branch of the large bookstore chain on the corner of Fifth Avenue and 18th Street. This has long been a magnet for poor, smart, driven

students willing to sit in the aisles and learn on their own.

Among the books he stumbled upon was a classic text on investing by William Sharpe, a professor at Stanford Business School who would later share a Nobel economics prize for his work on how efficient markets should price assets to reflect their risk. In a subsequent paper, Mr Sharpe put forward ideas on analysing the performance of investment managers by regressing their returns against various benchmarks. The aim is to figure out whether a manager's performance is attributable to his ability to pick securities, to leverage, to the specific sector in which he invested—in other words, whether he is genuinely producing “alpha” returns for each unit of risk run or is simply running more risks.

With another Russian émigré, Mik Kvitchko, Mr Markov was able to write a software program that captured the gist of this. Mr Sharpe himself found the work impressive, which was enough to launch a business. At first, the clients were investors evaluating mutual funds. In recent years, they have grown to include 200 of the world's largest financial institutions, and increasingly their interest has been in what and how well their hedge-fund investments are doing.

“Reverse engineering” a hedge fund's performance from the numbers supplied is a complicated business. The algorithms used for mutual funds had to be rewritten repeatedly because hedge-fund managers shift strategies, sell stock short and hold illiquid assets (which allows the unscrupulous to price at will for a time). Their infrequently published results, typically no better than monthly, are another problem. But after much testing, and depending on the strategy, Mr Markov reckons he can usually determine what a fund is doing and whether it does it well. Many that appear hot are merely the beneficiary of a risky quirk, such as leverage.

Daily results, Mr Markov says, would provide real transparency in most, but not all cases. That would no doubt please investors as well as the Securities and Exchange Commission, which has spent much of the past year grappling with what sort of disclosure to require in order to pre-empt trouble. At the end of the day, though, it is up to investors to do their own due diligence—or risk ending up down in the Bayous of this world.

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Economist.com FINANCE & ECONOMICS

Private equity in India

A new frontier

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Is India big enough for the industry's heavyweights?

Get article background

IT IS such stuff as private-equity dreams are made on. Between 1999 and 2001, America's Warburg Pincus, one of the biggest firms in the business, invested $292m in Bharti Tele-Ventures, an Indian firm riding the crest of a national tidal wave of mobile telephony. From August last year to this March, Warburg Pincus “exited” most of its investment, yielding just over $1 billion. Its residual stake in Bharti is worth some $700m. As deals in Europe and America become dauntingly competitive, India—along with China—has become global private equity's new frontier.

The Bharti investment has not been the only success in India for Warburg Pincus, which has been in the country since 1994. But it was, says the firm's Dalip Pathak, one of the best in its history, anywhere. Nor did it prompt the gold-rush among the firm's competitors. Last November, for example, General Atlantic and Oak Hill Capital Partners paid General Electric $500m for a 60% stake in its Indian outsourcing arm. But the Bharti deal was a landmark for India as a destination for private-equity investment. It showed not just that big money was to be made, but that the market was deep enough for a lot of profit to be taken at one go: in March, Warburg Pincus recouped $561m in one block sale. Nothing like it has been seen in China, for example.

Gaurav Dalmia, of First Capital, an Indian private-equity firm, argues that India offers a unique combination of size, fast-growing businesses and “reasonably robust” public markets for exit. Inevitably, scared of missing out, American giants of the industry are on the prowl. Blackstone opened an Indian office in May, with $1 billion allocated for investment in the country. The Carlyle Group has announced a substantial expansion in India. Texas Pacific hired Vivek Paul, then chief executive of Wipro, one of India's biggest information-technology and outsourcing firms, to scout for opportunities in India and elsewhere in business services, information technology and life sciences. Mr Dalmia says seven or eight funds are at present raising money for India.

Where is it all going to go? Optimists point to the magnitude of India's needs for investment—in infrastructure, manufacturing and finance, for example—and argue that, in Mr Pathak's words, “supply creates demand”. But Donald Peck, of Actis, another private-equity investor, which, as part of CDC Capital Partners, has long been active in India, points out that in the past five years there has only been one “orthodox” private-equity transaction each year worth more than about $50m—ie, big enough, in normal circumstances, to interest a billion-dollar fund. Actis itself has raised $400m for investment in India.

So competition, especially for big investments, is becoming fiercer. Of the three broad categories of private equity—venture capital for start-ups, buy-outs and “growth capital” for expanding firms—the third may have the biggest potential. For many investors, start-ups in most industries are too small. And although some big firms, such as Blackstone, prefer buy-outs, the Indian business environment is so complex that many outside investors want influence but not total control. That suits many Indian businessmen. Texas Pacific's Mr Paul says that in Silicon Valley,

where he lives, entrepreneurs want to build businesses and sell them. In India, they want to pass them on to their children.

Mr Dalmia describes this year's burst of enthusiasm for India as “a second coming”. In the late 1990s, venture capitalists rushed in to finance information-technology start-ups. This time much of the interest is in PIPEs, or “private investment in public equity”—ie, in companies already listed on the stockmarket. Many PIPEs do not give the investor rights in the management of the firm, and are not regarded by purists as “genuine” private equity.

There are many smaller deals, where the competition may come as much from the stockmarket as from rival private-equity firms. Last month 3i, a British firm, announced its first investment in India, $45m in Nimbus, a television- and film-production house with sports-rights interests. When Nimbus's Harish Thawani explains why he chose 3i over a stockmarket listing, he virtually presents the private-equity industry's own manifesto. Nimbus was six to eight quarters away from providing the sort of revenue stability that stockmarket investors like to see. Private-equity firms have more patience, typically looking for an exit within five to seven years. Furthermore, 3i, which will have two directors on a nine-member board, will be a “quasi-strategic partner”. It has 120 investments in other media firms, some of which will be potential customers.

Compared with Europe and America, India can still seem an empty playing field, at least for smaller deals. Ashish Dhawan of ChrysCapital, a Delhi-based investor, says that half his firm's deals are “proprietary”, ie, identified and negotiated without any competition. But, at the very least, the influx of new money is going to drive returns down. At worst, in Mr Dhawan's words, “a lot of bad promoters will get funded”—and those that invest in them will get burned.

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Economist.com FINANCE & ECONOMICS

Economics focus

Hard-landing heresy

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From The Economist print edition

If the dollar dives, what will happen to America's interest rates?

WHEN policymakers and pundits debate America's current-account deficit, the phrase “hard landing” is never far from their minds. It sums up what might happen if foreigners tired of financing the gap, now over 6% of GDP: a sinking dollar, soaring interest rates, tumbling asset prices—all dragging America's economy into recession.

Optimists, including Alan Greenspan, chairman of the Federal Reserve, think that all this is pretty unlikely. It is far more probable, they say, that America's imbalances will come right gradually, via a (gently) weakening dollar and slower demand growth at home. More pessimistic observers fear that the risk of a hard landing is rising. Some of these point to the financial crises that hit several emerging markets in the 1990s, in which currencies collapsed and interest rates climbed as foreign investors fled. The same could happen in America, they worry, once foreigners sour on Uncle Sam.

So far, the optimists have had the better of it. Foreigners have carried on lending to America, and at low rates of interest. Although the dollar has weakened, it has not crashed. But what if it did sink suddenly? Then, surely, the hard-landing logic would come into play: bond yields would rise sharply as investors demanded compensation for the risk of higher American inflation and further falls in the dollar.

Or maybe not. In a new paper*, Joseph Gagnon, an economist at the Federal Reserve, takes issue with this argument. It is true, he says, that currency crashes in emerging economies have sent interest rates soaring. And it used to be true of rich countries, too; but in the past 20 years their experience has been rather different. Since 1985, every industrial country whose currency has crashed—defined by Mr Gagnon as a depreciation of at least 8% in the first year and over 20% in two years—saw its bond yields fall, by 1.5 percentage points on average, the following year. Nor did bond yields rise much in anticipation of a currency's troubles: Mr Gagnon finds an average rise of only one-fifth of a percentage point in the year before a currency crash.

Mr Gagnon ascribes this change in rich countries' experience to the taming of inflation. A weaker currency might boost bond yields if investors fear higher inflation, or if they think monetary policy might be tightened to combat it. Yields might also be pushed up because investors fear further depreciation, or suspect that borrowers—in particular, the government—might default on their bonds. In rich countries, however, the default risk is remote, since rich countries issue debt mainly in their own currencies, so that the real burden of repaying debt does not rise after a depreciation. What really matters is the inflation risk, and this has become much less of a worry in the past 20 years. If inflationary expectations are falling, the link between tumbling currencies and rising bond yields may be weakened.

And another thing

Mr Gagnon's paper is one of several recent studies by Fed economists that dispute much conventional, pessimistic analysis of America's current-account deficit. Another†, by Hilary Croke, Steven Kamin and Sylvain Leduc, finds “little evidence” that shrinking current-account deficits in rich countries were accompanied by both sharply weaker currencies and recessions. Sometimes, the shrinking of a deficit went with a downturn—but with neither a plunging exchange rate nor rising interest rates. Sometimes, the currency dropped as the deficit narrowed—but then economic growth was strong. History suggests that not everything goes wrong at once.

Such studies might suggest that it is time for the pessimists to quell their fears. Or they might be a sign that the Fed's researchers are as sanguine as its officials, perhaps unwisely. Which?

Both studies may overstate the relevance to America of the other rich countries' experience. The sheer scale of America's economy and its borrowing may make it a case apart. In addition, American interest rates are already unusually low and although expectations of inflation are low and stable, they are not falling. A sharp fall in the dollar could therefore push inflationary expectations up. Perhaps most important is the role of foreign central banks, especially in Asia, in financing America's current-account deficit. Their willingness to devour American bonds has helped hold down American interest rates—maybe, reckon some, by two percentage points. If the central banks lost their appetite, the dollar could tumble while interest rates rose.

But Mr Gagnon has a counter-example. In 1997-98, Australia's dollar tumbled. Net foreign purchases of the country's bonds, worth 5% of GDP in 1996, turned into an outflow of 1% in 1998. Yet bond yields fell by more than two percentage points, partly because of the inflation-fighting reputation of Australia's central bank, but also because investors were worried about the country's growth in the wake of the Asian financial crisis.

The point is that there is no mechanical connection between currency crashes, long-term interest rates and the hardness of a landing. A fall in the dollar when America's economy was at full tilt ought to boost exports and might cause the economy to overheat; interest rates might rise, but no recession would ensue. Or a fall in the dollar might be the product of a slowdown—if, say, America's consumers stopped spending. Then lower, not higher, interest rates could ensue. Mr Gagnon has not refuted the idea that America could have a hard landing; but he has exposed some loose thinking on the subject.

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* “Currency Crashes and Bond Yields in Industrial Countries”. August 2005. Available at www.federalreserve.gov/pubs/ifdp/2005/837/ifdp837.pdf

† “Financial Market Developments and Economic Activity During Current Account Adjustments in Industrial Economies”. February 2005. Available at www.federalreserve.gov/pubs/ifdp/2005/827/ifdp827.pdf

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Economist.com SCIENCE & TECHNOLOGY

The Global Fund

Weaving a safety net

Sep 8th 2005
From The Economist print edition

Reuters

Tough times ahead for the Global Fund To Fight AIDS, Tuberculosis and Malaria

Get article background

IN A year when rich-country leaders have said so much about the need to help Africa, and to step up the fight against such scourges as AIDS, tuberculosis and malaria, you might think an international body set up to do just that would be overflowing with donations. But you would be wrong. This week, the Global Fund To Fight AIDS, Tuberculosis and Malaria—an organisation established in 2002 to mobilise and disburse international donations for projects to tackle these three afflictions—ended its latest attempt at fund-raising short of its goals.

The Global Fund estimates that it needs $7.1 billion from donors to fund projects in 2006 and 2007. At its “replenishment” conference this week in London, though, it received pledges totalling $3.7 billion. The fund reckons this is just enough cash to fill this year's shortfall of roughly $350m, and to pay for the renewal of projects already under way. What it does not allow, however, are any new projects over the next two years—unless more money is forthcoming.

Many organisations working in international development—more than 500 of which signed an international appeal for more money for the Global Fund—are disappointed with the outcome. But Richard Feachem, the fund's head, is hopeful about the prospects of making up the shortfall. New donors, he says, may be found among oil-rich Arab states and also from the private sector.

Indeed, several current donors, for example Canada, have yet to make concrete pledges for the coming two years.

Mind the gap

All eyes are now on America which, in the past, has contributed one-third of the Global Fund's money and has exhorted other donor nations to give more. In the next few weeks, Congress is due to sort out exactly how much America will give the fund for 2006. This is likely to be a sum between the $300m requested by George Bush and the $600m proposed by the Senate—all a far cry from the $1.2 billion that the AIDS lobby believes America should be giving next year to pull its weight. Bernard Rivers, who runs Aidspan, a Global Fund watchdog, reckons the fund will be hard pressed to get more than $5 billion for the coming two years.

The Global Fund is certainly not the only vehicle for financing poor-world health care: it accounts for only a quarter of donor spending on AIDS. But it also accounts for more than half of donor spending on malaria (on such things as insecticide-treated bed nets) and two-thirds of that on tuberculosis. And it is one of the more innovative efforts. By pooling money from different donors, it attempts to cut aid free from at least some of the strings associated with individual donors' bilateral assistance. Its approach to proposals submitted by recipient countries allows those countries a strong role in their own development, rather than merely telling them how the money should be spent. The results, so far, are promising. To date, the fund has pushed $1.5 billion out into the field, enabling 220,000 people with AIDS to start treatment, as well as 600,000 with tuberculosis and 1.1m with malaria.

Devolving responsibility in this way has its risks, of course. Last month, the Global Fund temporarily suspended grants to Uganda, after a whistleblower raised questions about how some local agencies were handling the money. The fund has committed more than $200m-worth of grants to Uganda, $45m of which has already been disbursed. But an investigation by PricewaterhouseCoopers, its auditors in Uganda, found numerous examples of improper accounting and inadequate management. The fund is now working with the Ugandan government to sort out the mess, in the hope of restarting the grants (see article).

Within the fund there are further challenges. Relations between its secretariat, the 150-odd staff who actually run the organisation out of Geneva, and its board, which oversees the organisation and has a say in the approval of grants, are not always easy. The two groups are now wrangling over whether to renew a particular grant to South Africa which the secretariat feels has not performed well enough to warrant more money, but which the board, which includes representatives from charities, recipient countries and those with AIDS, is reluctant to cut off. The fund has also asked the World Health Organisation's Office of Internal Oversight Services to look into several allegations of internal mismanagement.

Such problems are not unique to the fund, of course. What is unusual is the extent to which it deals with some of its thornier issues in public. Indeed, according to Hilary Benn, Britain's secretary of state for international development, the open and transparent way in which it behaves has increased donor confidence.

For all its teething troubles, the fund has proved a good way for world leaders to honour their pledges to do more for international public health. But to do even better, it needs to professionalise its operations and bring in more people with strong experience in business and finance to manage the billions of dollars it seeks to attract in future.

Economist.com SCIENCE & TECHNOLOGY

Drugs for poor countries

A promising prognosis

Sep 8th 2005
From The Economist print edition

New hope in developing drugs for the poor

"BIG pharmaceuticals...right up there with the arms dealers," says a character in "The Constant Gardener", a newly released film of John le Carré's novel about drugmakers' dodgy dealings in Africa (see article). In fact, as well as fiction, pharmaceutical firms have been lambasted for their approach towards the developing world—be it prices and patents hampering access to existing medicines, or negligible investment in new drugs for diseases that mainly afflict the poorer parts of the planet.

But research by Mary Moran and her colleagues at the London School of Economics, published in *Public Library of Science Medicine*, paints a brighter picture. Dr Moran's team looked at the state of drug research and development for ten "neglected" diseases of the developing world, including malaria and tuberculosis, which kill roughly 3m people a year and debilitate millions more. These have not been particularly interesting markets for big pharmaceutical firms to spend their R&D cash on, compared with, say, new anti-cancer drugs for the rich world. Between 1975 and 1999, only 13 new drugs for neglected diseases were developed, and many big drugmakers got out of the business of tropical disease altogether.

According to Dr Moran, however, there has been a significant increase in activity since 2000. There are now at least 63 active drug-development projects for neglected diseases, with 18 potential drugs in clinical trials. Given normal levels of success (drug development has a high attrition rate), this could mean that eight or nine new drugs will be ready for use over the next five years, a distinct improvement on past performance. Indeed, two are already sitting in the "in" trays of the regulators, awaiting their blessing.

The main reason for all this renewed activity seems to be the emergence in the field of public-private partnerships. These serve to co-ordinate contributions from companies and academic centres, manage R&D portfolios and, crucially, raise money to fund the entire enterprise from sources such as charitable foundations. They account for three-quarters of the neglected-disease drug projects. This means that big drugmakers can shift much of the cost of R&D—particularly the risky business of clinical trials in developing countries—to the partnerships, leaving them to concentrate on the less costly business of early-stage research. So, although they may have little expectation of big profits, the firms are managing to limit their costs. That allows them to repair the tattered public image that gave rise to "The Constant Gardener", build good government relations, and even cultivate commercial partners in countries that might one day become paying markets without having to shell out too much shareholders' money.

Mixing for-profit and not-for-profit cultures is never easy, of course, and the partnerships are sometimes tricky to manage. However, as Dr Moran argues, they are starting to deliver the goods at reasonable cost. Between 2000 and 2004, the partnerships managed to take 40 development projects forward on a paltry $112m. But starting is not finishing. As these projects go into the later, costlier stages of development—particularly large-scale clinical trials—the partnerships will need money on a scale that, in the absence of the profit motive, only governments are likely to be

able to satisfy.

At the moment, government funding accounts for less than 20% of the partnerships' finance. Indeed, in Dr Moran's opinion, current proposals—such as advanced-purchase commitments, in which governments try to create a paying market by promising to buy large amounts of new products designed to combat neglected diseases—run the risk of swaying industry toward for-profit, do-it-yourself drug development. It is indeed an irony that, in the area of tropical disease, the wicked drug firms have discovered the value of not-for-profit business at precisely the point when governments are contemplating the idea that the best way forward is the use of incentives more attuned to red-in-tooth-and-claw capitalism.

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Nuclear power

Little to fear but fear itself

Sep 8th 2005
From The Economist print edition

Chernobyl's legacy

AP

Get article background

A sign of the times

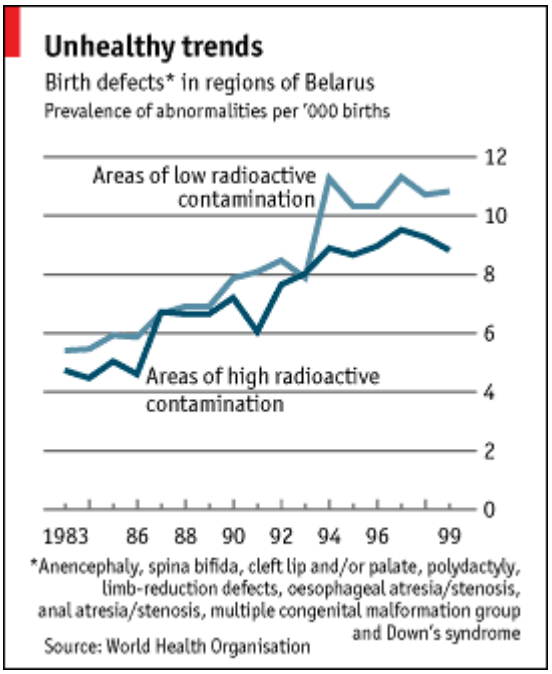
IN 1986 the Ukrainian town of Chernobyl was the site of the world's worst nuclear power-plant accident. Almost 30 people died from radiation sickness in the immediate aftermath, and several hundred were hospitalised. Millions more were exposed to radiation from the plant, and 350,000 were permanently evacuated from their homes. But the tens of thousands of premature deaths predicted by some—and expected by many of those exposed—have failed to materialise. That is good news. The bad news is that the expected legacy of deaths from cancer has turned into a real legacy of “paralysing fear”.

That, at least, is the conclusion of a newly published report compiled by the Chernobyl Forum, a group of several hundred scientists, economists and health experts supported by the three governments involved—those of Ukraine, Russia and Belarus—and by the United Nations. The forum is not sanguine. It observed a rise in cancers such as leukaemia in the most highly exposed emergency and recovery workers. And although tens of thousands of deaths have not materialised, it does predict that 4,000 people will eventually die from cancer attributable to exposure from radiation leaked from the plant. But while that sounds a lot, it would represent an increase of only about 3% in the number of cancer-related deaths among the 600,000 emergency workers, evacuees and residents of contaminated areas originally identified as being at risk. That is because about a quarter of these people would be expected to die from cancer even had they not been exposed to Chernobyl's radiation. On top of that, one of the biggest worries at the time of the accident—thyroid cancer—did not prove as bad as feared. Although 4,000 children contracted it by drinking contaminated milk, only nine died. As for the 5m people who still live in contaminated areas, most have exposures to radiation that remain within the recommended dose limit. Only 100,000 of them receive more than they should.

The forum's members were unable to examine all the potential effects of Chernobyl's radiation, says Fred Mettler, a professor of nuclear medicine at the University of New Mexico who led the team investigating health effects for the Chernobyl Forum. They picked the ones they thought most important. Some researchers, for example, think radiation can cause diabetes. However, the data were not sufficiently good to examine this theory.

Perhaps the true tragedy of Chernobyl is that the biggest observable health impact so far has been on the mental health of the millions who have been told they are at risk. Many of these people received radiation doses no larger than they would get on a holiday in a place such as Denver,

where the altitude increases exposure to cosmic rays, yet they have spent their lives anticipating illness and incapacity, and this has translated into such undesirable behaviours as drug abuse and long-term dependency on the state.



High on the list of things that need to be done, therefore, is to change assistance programmes that foster a victim mentality. Instead, people need reassurance that they have not been harmed by radiation. For example, says Dr Mettler, many now wonder if they can safely have children.

The answer is that they can—or, at least, if they cannot, it is nothing to do with Chernobyl. Although the rate of birth defects is increasing in Belarus, the rise is happening in both contaminated and uncontaminated areas. In fact, the data (see chart) show that unexposed areas actually have a higher rate of congenital abnormalities, so whatever is causing the rise is unlikely to be connected with the accident.

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Economist.com SCIENCE & TECHNOLOGY

Human evolution

Three of a kind

Sep 8th 2005
From The Economist print edition

Some very human genes

HAVING been trumped last week by the decision of the chimpanzee genome-sequencing consortium to publish in their rival, *Nature* (see article), the editors of *Science* have now got somewhat of their own back with a trio of papers that look at genes which seem to be involved in the evolution of the human brain.

Two of these papers reported studies carried out by Bruce Lahn, of the University of Chicago, and his colleagues. Dr Lahn has been studying two genes that tell the brain what size to grow to. If either of these genes, known as *Microcephalin* and *ASPM*, fails to do its job properly, the result is a brain that, though normal in its structure, is far smaller than it ought to be—somewhere between a quarter and a third of the normal volume—and which does not work properly. One of the characteristics of *Homo sapiens* is an exceedingly large brain, and some biologists have speculated that changes in these two genes might be part of the cause of this enlargement. Those speculations have been supported by evidence that these genes have changed significantly since the human and ape lines separated several million years ago.

Dr Lahn has added to that evidence, and has shown that this evolution continued even after *Homo sapiens* became a species in its own right, less than 200,000 years ago. One variant of *Microcephalin*, now widespread, came into existence only about 37,000 years ago, while a widespread version of *ASPM* originated a mere 5,800 years ago—meaning that it post-dates the beginning of civilisation.

Dr Lahn and his team were able to estimate the dates that the two gene-variants first appeared by looking at which groups of people have them. The past two decades have revealed a lot about how humanity has spread across the globe, and when. By tracing branches of the family trees containing the variants in question backward until they join, the dates at which the variants appeared can be worked out.

That the two variants have spread by natural selection rather than chance can be seen from the speed with which they have become established. If they had no positive consequences, their frequency would rise, if at all, by chance—a process known as neutral drift.

The third paper, by Toshiyuki Hayakawa and Takashi Angata, of the University of California, San Diego and their colleagues, looks at a molecular receptor for a chemical called sialic acid. This chemical caused a stir a few years ago when it was discovered that human sialic acid is different from that found in apes—and, indeed, any other mammals. Dr Hayakawa and Dr Angata have found a receptor for sialic acid that occurs in human brain cells (though the cells in question are support cells rather than actual nerve cells), but not in those of apes. The gene that encodes this receptor molecule seems to have been cobbled together from bits of two other genes one of which, in a curious twist, had itself stopped working properly during the course of evolution.

What all this means is still mysterious. The study of brain evolution is still in the stamp-collecting

phase that begins most branches of science, when researchers are looking for interesting facts to stick in their albums, rather than assembling overarching hypotheses. These three stamps, though, are very pretty. Eventually, they may turn out to be precious.

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American wine

Supersipping in the superstate

Sep 8th 2005 | LOS ANGELES
From The Economist print edition

Alamy

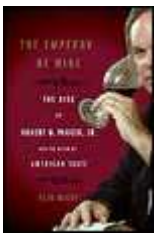
Winegrowers of the world now have to bow to American taste

THE vocabulary of wine gushes with references to fruit, flowers and vegetables, but the French have added a new, implicitly disdainful adjective: *Parkerisé*. It means a wine designed to appeal to Robert Parker, described by Elin McCoy as the world's single most influential critic. His judgment, expressed through his newsletter, the *Wine Advocate*, can make or break a winemaker, and be the difference between profit and loss for those sad people who buy wine merely as an investment. As even the noblest domaines of Bordeaux and Burgundy have come to recognise, it is American taste, most notably Mr Parker's, that now rules the world of wine.

Is that such a bad thing? Only the most absurdly prejudiced Francophile would deny the excellence of many wines from California or Chile, Australia and New Zealand. It is almost 30 years since the “Paris tasting”, when top French critics in a blind-tasting shocked themselves by choosing a 1973 Stag's Leap Wine Cellars Cabernet over a 1970 Mouton-Rothschild and Haut-Brion (six of the 11 best-rated wines in the tasting were from California). Paul Lukacs's selection of 40 American wines can certainly hold its place against foreign competition.

Yet there is a difference, one that can perhaps be summed up as art

The Emperor of Wine: The Rise of Robert M. Parker, Jr. and the Reign of American Taste
By Elin McCoy



Ecco; 342 pages; $25.95

Buy it at
Amazon.com
Amazon.co.uk

A History of Wine in

versus science. The traditional winemakers of France—and, for that matter, other parts of the Old Continent—prize the *terroir*, that complex mix of soil, air, climate and so on that lends each wine its individual character. But the winemakers of America, often wealthy newcomers from the world of dotcom, have shown that a very good wine can be created by following a set of rules, from the time to pick the grapes to the right amount of micro-oxygenation (adding a touch of oxygen to soften the tannins). No wonder France's wine labels denote their place of origin; California's their choice of grapes.

Mr Parker's role in the argument is crucial. His judgment in the *Wine Advocate* comes not just in his tasting notes (a favourite adjective is "jammy") but in the score, out of 100, that he gives each wine. Any wine will get 50 points just for "showing up"; another 5 are available for colour and appearance; 15 for the bouquet; 20 for flavour and finish; and 10 for overall quality and the ability to age well. Apply the formula to Bordeaux wines, supposed to improve with age, and any score above 90 will ensure a high price in what amounts to a futures market; anything less is a disaster—even though Mr Parker himself describes wines scoring in the 80s as "very good" and 75-79 as "above average".

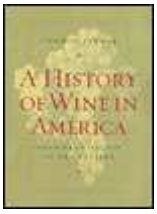
If the Parker rating is what counts, how do you score well? Ms McCoy, in her eminently readable book, writes: "As dozens of winemakers have told me, 'If I want to make a 95 Parker wine, I know what I have to do.' " Indeed so: thin the vine leaves to allow more sun to hit the grapes; reduce the number of grape clusters in order to concentrate the flavour in the ones remaining; harvest the grapes as late as possible; and use processes called cold maceration and malolactic fermentation to deepen the wine's colour and smooth out its tannins. In other words, arrive at the full-bodied, strong and rich wines typical of California. If you need help, you can hire Michel Rolland, a peripatetic winemaker and a friend of Mr Parker's. Or in California you can contact Leo McCloskey, whose Enologix company claims to have cracked the scientific formula for a 90+ wine.

Not even his fiercest rivals would dispute Mr Parker's particular genius: his ability to keep a judicious and rigorously independent head while tasting some 10,000 of the world's wines a year is truly remarkable (and was personally rewarded by President Jacques Chirac with a *légion d'honneur*). And it would be churlish not to admire the rise to fame (and fortune) of a small-town American who, as a young lawyer, would search for interesting wines while most of his contemporaries were more inspired by Coca-Cola and cold beer.

Yet the notion of a precise score-card is hard for most connoisseurs to accept. Mr Lukacs rightly notes the "illusion of objectivity", explaining that "it matters a great deal who is assigning the points—not only in terms of the critic's personal preferences but also in terms of context." Thomas Pinney, in his magisterial work (a previous volume covered America's wine before prohibition), cannot even bear to mention Mr Parker and his *Wine Advocate*: "There is an obsession with prices...an obsession with ratings, a touching dependence on the judgments of the supposed wine experts, and an obsession with having only the best, accompanied by an anxious display of knowingness and a corresponding fear of revealing ignorance."

Mr Pinney is right. Even though America is now the world's fourth-largest wine producer (after Italy, France and Spain), Americans tend to feel uncomfortable with wine. Puritan instincts live on: an 18-year-old can vote, marry or die in Iraq, but cannot legally drink a glass of wine.

America: From Prohibition to the Present
By Thomas Pinney



University of California Press; 532 pages; $45 and £29.95

Buy it at
Amazon.com
Amazon.co.uk

The Great Wines of America: The Top Forty Vintners, Vineyards, and Vintages
By Paul Lukacs

Norton; 384 pages; $29.95 (to be published in November)

Buy it at
Amazon.com
Amazon.co.uk

Will America's attitude to wine change? Pessimists point to Prohibition as proof of an abiding fear of alcohol; optimists say its repeal, well described in Mr Pinney's elegant prose, is proof that fear has given way to realism. Meanwhile, all three of these books—Ms McCoy's impartial assessment of Mr Parker's taste and influence, Mr Pinney's encyclopedic study and Mr Lukacs's guide to America's best wines—should add new converts to the pleasures of the vine.

The Emperor of Wine: The Rise of Robert M. Parker, Jr. and the Reign of American Taste.
By Elin McCoy.
Ecco; 342 pages; $25.95

A History of Wine in America: From Prohibition to the Present.
By Thomas Pinney.
University of California Press; 532 pages; $45 and £29.95

The Great Wines of America: The Top Forty Vintners, Vineyards, and Vintages.
By Paul Lukacs.
Norton; 384 pages; $29.95 (to be published in November)

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Economist.com BOOKS & ARTS

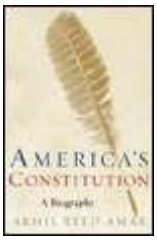
America's constitution

What the writers intended

Sep 8th 2005
From The Economist print edition

NO MODERN text has been more intensely and intelligently analysed than the fewer than 8,000 words of the constitution of the United States. Akhil Reed Amar, a Yale law and political science professor, has written an original, thorough and opinionated guide to the goals and meaning intended by those who drafted and ratified the original 1787 document and its 27 amendments.

America's Constitution: A Biography
By Akhil Reed Amar



Random House; 672 pages; $29.95

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Amazon.co.uk

He opens with the mighty words of the preamble: “We, the People...do ordain and establish this Constitution.” This statement and action, Mr Amar asserts, “was the most dramatic deed the world had ever seen.” The malignancy within the original constitution was the result of the need to have it ratified by the southern colonies. Not only was slavery recognised but slaveholders were rewarded with unjustifiable political power. If electoral votes had not been apportioned on a basis that increased the voting power of whites in proportion to the number of slaves in their state, John Adams not Thomas Jefferson, the draftsman of the Declaration of Independence and a slaveowner, would have won the first contested election for president.

The constitutional basis of most governmental regulation rests on what lawyers call the “commerce clause”—the power of Congress to regulate “Commerce with foreign Nations, and among the several States.” American conservatives are successfully mounting attacks on laws prohibiting the possession of guns near schools on the grounds that only economic relationships can be regulated. But Mr Amar points out that commerce “in 1787 had a broader meaning, referring to all forms of intercourse in the affairs of life,” and that without employing this broader interpretation it is unclear how the government would have the necessary power to deal with non-economic inter-state affairs.

Although Mr Amar is generally classified as a liberal, his analysis is even-handed. In a complex and compelling argument he demonstrates that the right to bear arms, guaranteed by the second amendment in 1791, was not at that time conceived as a personal right. Consequently it did not apply to bearing a weapon for self-protection or hunting. It was intended to preserve the state militias that won the war for independence, reflecting a distrust of a national army.

However, the 14th amendment, ratified in 1868, embodies the personal right to bear arms. This post-civil-war amendment, made possible only by the victory of the national army against the southern militia in America's bloodiest conflict, was intended to include the right of women and freed blacks to protect themselves.

It is disappointing that Mr Amar consistently declines to apply his historical approach to current controversies. His belief that the second amendment viewed through the gravitational lens of the 14th provides the right to protect one's home and property leaves open the extent to which that

right can or cannot be curtailed. The issue of the right to bear arms is a tar pit the Supreme Court has avoided for over half a century.

Among Mr Amar's more startling positions is the unconstitutionality of the law governing presidential succession. Under a 1947 enactment, in the event of the death, resignation or inability of both the president and the vice-president, the next in line of succession is the speaker of the House. But Article II of the constitution requires the devolution of the power of the presidency to an “officer” and it is unlikely that a member of Congress is an “officer” in the constitutional sense.

Until 1947, the designated successor was the secretary of state, undoubtedly a constitutional officer and also likely to possess greater stature than the speaker. However, if the issue were to arise, the judiciary is unlikely to play a role. Once the speaker is sworn in as president, it would be almost unthinkable for the courts to provoke a crisis by considering the legality of the act.

The indispensable starting point for construing the constitution has to be the document's original meaning. And the best available guide to what the draftsmen originally meant is contained in Mr Amar's excellent “biography”.

America's Constitution: A Biography.
By Akhil Reed Amar.
Random House; 672 pages; $29.95

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Economist.com BOOKS & ARTS

Medieval England

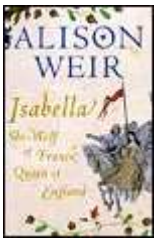
Quite a queen

Sep 8th 2005
From The Economist print edition

THE life of a medieval queen of England was precarious, particularly if she happened to be French and her husband was almost certainly a homosexual. This was the situation that faced Princess Isabella when, aged probably 12, she married King Edward II, aged 23, in 1308.

Despite these obstacles, Isabella lived another 50 eventful years and left a considerable mark on 14th-century Europe. She helped her husband crush revolts, narrowly avoided capture at the hands of Robert the Bruce, played a key part in keeping the peace between France and England, led an invasion that overthrew her husband, virtually ruled the kingdom with her adulterous lover and was in turn deposed by her own son, Edward III. Oh, and she may or may not have been responsible for the death of her husband, brutally murdered with a red-hot poker. Certainly a subject that merits a full-length modern biography.

Isabella: She-Wolf of France, Queen of England
By Alison Weir



Jonathan Cape; 512 pages; £20

Buy it at
Amazon.co.uk

Yet writing medieval history presents difficulties. Since sources are limited and often unreliable, it is hard to work out how decisions were reached, let alone exactly how they were implemented. This puts a premium on writers explaining fully how their ideas and theories are arrived at. Alison Weir, a prolific biographer of historical figures, does this only sparingly, often making rather bald assertions.

In her introduction, Ms Weir promises a sympathetic portrayal, and she lives up to her word. This reveals both the strength and the weakness of her book. Her fair-minded examination of Isabella's motives and actions helps the reader to understand the queen, and to sympathise with much of what she did. But this is achieved at the cost of making other key figures, such as her husband and his probable lover, Piers Gaveston, into caricatures, almost comic-book villains.

A number of fascinating ideas are developed, most notably that Edward may have escaped foul murder and lived out his days wandering Europe disguised as a friar. Tempting as such a theory is, the evidence does not quite stack up. It all relies a bit too much on ifs and buts.

In her conclusion, Ms Weir remarks that “Isabella's importance in the history of Britain cannot be overestimated.” She was interesting, yes indeed, but perhaps the author is pushing the lady's importance a little too insistently.

Isabella: She-Wolf of France, Queen of England.
By Alison Weir.
Jonathan Cape; 512 pages; £20

New films

Hothouse plants

Sep 8th 2005
From The Economist print edition

A thriller redeemed by its heroine and Africa's streets

RARELY do films turn out to be better than the books that spawn them, but “The Constant Gardener” is one. John le Carré's 2001 thriller about greedy pharmaceutical companies exploiting innocent Africans was thin, and that's being polite. The film, which received an enthusiastic welcome at the Venice film festival earlier this month and which has just opened in America (it opens in Britain in November) is far, far better.

Ostensibly about the collision of profit and political intrigue, “The Constant Gardener” is in passing also a love story. Yet it is the love story that gives meaning to everything else. Tessa Quayle (Rachel Weisz) is the wife of Justin (Ralph Fiennes), a young British diplomat with thin fingers and a way with petunias. As the film opens, she is hanging from a tree by a lake in Kenya's Rift Valley. A young African friend is the main suspect.

Her murder forces Justin to re-examine his wife, whom it becomes clear he never really knew. Told in a clever mix of forward motion and flashback, the Quayles' story evolves from their first meeting, at a lecture of his where she is an impassioned and out-of-control heckler, through their early marriage, their transfer to Kenya, her pregnancy and the beginnings of her journey of discovery about the evils of Big Pharma. With her death, Tessa's journey becomes Justin's obsession.

Two things distinguish this film: Ms Weisz's acting and Fernando Meirelles's directing. “The Constant Gardener” is the film that will make you fall in love with Rachel Weisz. If her Tessa character occasionally stretches credulity—no white woman, however politically committed, would opt out of Kenya's hygiene apartheid and risk her first baby by giving birth in Nairobi's Pumwani maternity clinic—it is Mr le Carré's fault. The throaty smile and full-bodied performance are Ms Weisz's own.

Similarly, Mr Meirelles extends to Africa the same fearless embrace he extended to the slum children of Brazil in his Oscar-nominated “City of God”. By making you feel you are there, joshing with the kids and sloshing in the ditches of the back streets of Nairobi, he pushes aside a generation of pristine European films about Africa, and reaches back to one of the finest films of the past two decades, Claire Denis's 1988 memoir, “Chocolat”. Mr le Carré is a lucky man.

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New fiction

Black, fat and feisty

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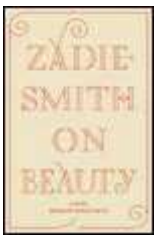
From The Economist print edition

IN HER third novel, Zadie Smith, a British writer, turns racial stereotypes on their head. The liberal, an academic named Howard, is a white Briton. The conservative, a competing Rembrandt scholar named Monty, is a black Briton. Stirring the cultural pot, both are transplanted to a Harvard look-alike in Massachusetts, and Howard is married to an amply proportioned African-American called Kiki.

Modelled on “Howard's End” by E.M. Forster, “On Beauty” (which has been short-listed for the 2005 Man Booker prize) is shot through with race. Perhaps blessedly, the novel never rounds on a particular agenda, save from implying that black identity is complicated by economic success. Howard's son Levi, though middle-class, affects a tough Brooklyn accent from the projects, and artificially adopts the nationalist cause of his footloose Haitian “brothers”. Howard's daughter flirts with an identity more of “the street” when she falls for an uneducated rapper who himself yearns for the legitimacy of university life.

On Beauty
By Zadie Smith



Penguin Press; 464 pages; $25.95
Hamish Hamilton; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Howard and Monty detest each other, although the grounds for their antagonism feel a mite contrived. The intellectual arguments that put their families at odds—affirmative action, Rembrandt, black “victim culture”—never quite come alive.

Yet the characters do, and in a novel that's really the test. Ms Smith may have crowded her novel a bit (her bestselling debut “White Teeth” suffered from a similar overpopulation), but it is still impressive that she can create such a large cast of fully fledged characters. Kiki is especially well drawn; her indignation when Howard has an affair with a scrawny white colleague rings true: “My leg weighs more than that woman. What have you made me look like in front of everybody in this town? You married a big black bitch and you run off with a fucking leprechaun!”

Ms Smith has her shortcomings. The novel's first half is under-edited; surely we do not need to meet every guest at an anniversary party. Switching a point of view mid-paragraph is bad form. “People-carrier” strains for a synonym for taxi when “cab” would have done nicely. It is hard to believe that Monty would still say “coloured people”. The dialogue's excess of italics is amateurish.

Nevertheless, the book gathers momentum, and the second half gallops along. Ms Smith turns many a fine phrase: Monty has a “gallingly pretty daughter”; manuscript pages from Howard's printer seem to have been “spewed from the machine in disgust”. While the plot doesn't quite build to the climax one might hope for, a lovely boisterousness and joy in spoken language carry it through.

On Beauty
By Zadie Smith.
Penguin Press; 464 pages; $25.95

Economist.com BOOKS & ARTS

Shakespeare in Kabul

Why, all delights are vain

Sep 8th 2005 | KABUL
From The Economist print edition

A magic performance in a dusty Afghan garden

AS IN Shakespeare's comedies as in life, joy is tinged with sorrow. And nowhere more than in Afghanistan, where international efforts to heal the broken country are dogged by grief, after a quarter-century of war, and fear of what may be to come when the peacekeepers depart. The wonderful production of “Love's Labour's Lost” that has just been running in Kabul—Afghanistan's first professional theatre since the fighting began—reflected this hard truth.

Several of the actors had seen relatives killed or been wounded themselves. And in Afghanistan, even after the Taliban, a woman on stage is thought no better than a prostitute. As the call to evening prayer echoed through the garden where the last performance was held on September 5th—and where Zahiruddin Muhammad Babur, the founder of the Mughal empire lies buried—the audience fell guiltily silent.

Translated into Persian in Iran, and directed by an energetic French actress, Corinne Jaber, the play was adapted for a naive Afghan audience. The four gentlemen who, in Shakespeare's original, give up love for a year, then fall helplessly for the next four women they meet, were played as nobles of Kabul; the women were from Herat. The scene where the men disguise themselves, unsuccessfully, as Russians to press their suits, presented a problem: none of the male actors wanted to play Russians, their country's invaders. They played instead a bunch of itinerant Indian dancers, and very funnily too.

Another problem was finding women actors; and all those who Ms Jaber did find had suffered, for their acting or for other reasons. One was later thrown out of her house for appearing in the play.

Bereshna Bahar, another actor, was widowed by an artillery round in 1992 and left with two daughters to feed. In Taliban times, she went hungry. Since then, she had eked out a living acting in television and films at $20 a throw; for this British-backed production, the actors earned $600. Marina Gulbahari, a remarkably beautiful actor who was the child star of “Osama”, a film about Taliban times that won a Golden Globe, was discovered by the film's director begging in Kabul. “I had never heard of Shakespeare before,” she said. “But I like this story from the beginning to the end.”

Having cast her production, Ms Jaber had no problems putting the male and female actors together—even during the daily pre-rehearsal volleyball games. She now hopes to take it on tour, to Herat and Mazar-e-Sharif, and maybe to Britain. Otherwise, her cast's careers remain in a parlous way. Until recently, Afghanistan's state television banned broadcasting of women singers. Now, with many unreformed conservatives in power, it may do so again.

The audience reflected these mixed views. Mostly, the 200 or so Afghan men present seemed to have enjoyed the play, but some questioned whether the actors should have held hands at the curtain-call. The western diplomats, aid workers and journalists present were unreserved in their praise. But with America planning to withdraw many of its 18,000 troops next year, the presence

of interested foreigners may diminish. In Afghanistan as in Shakespeare's comedies, the future is less rosily settled than it may seem. As it is said in “Love's Labour's Lost”: “Worthies, away! The scene begins to cloud.”

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Obituary

William Rehnquist

Sep 8th 2005
From The Economist print edition

Corbis

William Rehnquist, America's chief justice, died on September 3rd, aged 80

Get article background

LUCKILY for him, William Rehnquist did some of his war service in Casablanca. As a weather observer, his job was to plot synoptic maps and launch wind balloons into the deep blue North African sky. Weather intrigued him, he used to say, because although it could be forecast with some accuracy, it could not be changed.

You could argue, however, that in his 33 years on the Supreme Court Justice Rehnquist came as close as anyone to changing the prevailing climate in the United States. From a solitary storm-front, rumbling away by himself against the liberalism, activism and soft-heartedness of the court Earl Warren had established in the 1960s, he gradually came to tower over a conservative consensus not only in the court, but in the country. By his death—from thyroid cancer, through which he was still working—four other members of the nine-member court were prepared, usually, to go along with his opinions. Justice Rehnquist's tenacity and industry thus enabled him to set his stamp on a large body of law.

He showed, too—surprisingly for a big, shambling man who liked boaters and loud ties—a capacity to be subtle, even invisible, in the making of argument. He was never a table-thumping hardliner like his colleague Antonin Scalia, preferring broad compromise if he could get it. The routine 5-4 split in the Rehnquist court bothered him, because he thought it dented the credibility of the law in general.

His own legal philosophy could be summed up fairly simply. He believed in pluralistic government,

and in particular that power should be devolved from the federal government to the states. (The Rehnquist court restored to view, and to great effect, the commerce clause of the constitution, rolling back laws passed by Congress on the pretext of regulating inter-state trade.) He had no respect for the burgeoning discovery of individual rights in those bits of the constitution that guarantee due process and equal protection of the laws. He believed that judges should be lawyers, not policymakers.

In most of those opinions he had not changed since his appearance, in pink shirt and luxuriant sideburns, in Richard Nixon's Justice Department in 1969. He had imbibed his ideas from the anti-socialist works of Friedrich von Hayek, as well as from the middle-class suburban air of Shorewood, Wisconsin, where he had grown up. Stanford and Harvard made no impression on his views. Indeed, when he met liberalism, it merely confirmed his dislike of it. When, as assistant attorney-general in the Office of Legal Counsel, he presented to the court the Nixon administration's enthusiastic views on wiretapping, police immunity and pre-trial detention, he shared them all.

Richard Nixon picked him for the court in 1971. He was so close to the administration that he recused himself from the unanimous vote, in 1974, to force the president to give up the Watergate tapes. But Nixon hardly knew him, calling him “Renchburg” and “that clown”. Justice Rehnquist's lonely path in his early years on the court—one of only two dissenters, for example, in the *Roe v Wade* ruling that legalised abortion—sprang from his own loathing of justices “making the constitution say what they wanted it to say.”

Four rows of braid

His confirmation hearings for both associate justice and chief justice (at Ronald Reagan's behest, in 1986) were some of the stormiest seen on Capitol Hill. Each time, more than a quarter of the senators rejected him. Opponents discovered that he had opposed desegregation of schools and public housing in Arizona. Most damagingly, they turned up a 1952 memorandum in which he supported the “separate but equal” *Plessy* ruling of 1896, which had established segregation. Justice Rehnquist insisted these were not his views, but those of Justice Robert Jackson for whom he was clerking at the time. Few believed him.

As chief justice, however, he put his name to some liberal opinions: for gay rights, for free speech and in support of *Miranda*, the right to remain silent. The key to his flexibility, beyond his care for consensus, was his conviction that judges were not all-wise, but fallible sharers in the work of government. In 1995 he suddenly adorned his black robe with four rows of gold braid, thus presiding splendidly over the impeachment trial of Bill Clinton four years later. As he hoped, it made him look like the Lord Chancellor from Gilbert and Sullivan's “Iolanthe”. “The Law is the true embodiment / Of everything that's excellent”, sang that worthy, “and I, my Lords, embody the Law.” Justice Rehnquist never took himself so seriously.

Almost the last glimpse the public had of him was in January this year, when he administered the oath of office to George Bush. The president had come to the White House, in 2001, only because Justice Rehnquist had written the majority opinion which had, at last, stopped the Florida recounts. A Republican chief justice, it seemed, had picked the president, and half America had been appalled. Now, in 2005, Mr Bush had been re-elected by a solid majority of Americans happy with his conservatism. And Justice Rehnquist—though bareheaded and ill, pitifully underclad for the cold, with his tracheotomy tube wobbling at his throat—was basking in the climate he had helped to create.

Overview

Sep 8th 2005
From The Economist print edition

Oil prices fell from record highs. The price of West Texas Intermediate, a benchmark crude, slipped below $65 a barrel from a record of $70.85 last week, when Hurricane Katrina hit production and refining operations in the Gulf of Mexico.

Firms in **America** added 169,000 jobs to non-farm payrolls in August. The figures for June and July were revised up by 44,000 in total. The unemployment rate declined to 4.9% in August, compared with 5.0% in July.

The **euro area's** unemployment rate dropped to 8.6% in July from 8.7% in June, possibly due to a fall in participation rates rather than an increase in the number of jobs. Meanwhile, industrial activity in **Germany** posted unexpectedly strong gains in July. Industrial production rose by 1.2% and manufacturing orders were up by 3.7%, boosted by foreign demand for capital goods.

Japanese household spending fell by 4.0% in nominal terms in the year to July, the sixth consecutive monthly decline.

Industrial production in **Britain** fell by 1.6% in the year to July, following an even sharper decline of 2.0% in the year to June.

Australia's economy grew by 2.6% in the year to the second quarter, up from 1.9% in the year to the first quarter.

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Output, demand and jobs

Sep 8th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q2	+ 5.2	+ 2.4	+ 3.2	+ 1.2	Q1	+ 1.6	Q2	5.0	Aug	5.7
Austria	+ 2.0	Q1	+ 0.8	+ 1.9	+ 2.0	+ 5.8	Jun	+ 1.7	Jun	5.2	Aug	4.9
Belgium	+ 1.5	Q2	+ 1.2	+ 1.2	+ 1.9	– 4.0	Jul	+ 5.9	Jun	13.4	Jul†	12.8
Britain	+ 1.7	Q2	+ 1.5	+ 2.0	+ 2.2	– 1.6	Jul	+ 1.8	Jul	4.7	Jun††	4.8
Canada	+ 2.7	Q2	+ 3.2	+ 2.8	+ 3.0	+ 0.4	Jun	+ 5.6	May	6.8	Jul	7.1
Denmark	+ 0.8	Q1	+ 0.6	+ 2.0	+ 2.2	– 1.6	Jul	+ 6.1	Jul	5.8	Jul	6.2
France	+ 1.2	Q2	+ 0.4	+ 1.4	+ 1.8	– 0.4	Jun	– 1.2	Jul	9.9	Jul	10.0
Germany	+ 0.6	Q2	nil	+ 0.9	+ 1.3	+ 3.0	Jul	– 3.0	Jul	11.6	Aug§	10.6
Italy	+ 0.1	Q2	+ 2.8	– 0.2	+ 1.0	– 3.0	Jun	– 1.5	Jun	7.8	Mar	8.2
Japan	+ 1.4	Q2	+ 1.1	+ 1.9	+ 1.9	– 2.2	Jul	+ 3.6	Jun	4.4	Jul	4.9
Netherlands	+ 1.3	Q2	+ 4.9	+ 0.5	+ 1.6	– 0.1	Jun	+ 1.2	Jun	6.7	Jul**	6.5
Spain	+ 3.4	Q2	+ 3.6	+ 3.2	+ 2.8	– 0.2	Jun	+ 0.4	Jul	9.4	Jul	10.9
Sweden	+ 2.2	Q2	+ 2.4	+ 2.1	+ 2.7	+ 2.6	Jun	+ 8.6	Jul	6.9	Jul†	5.6
Switzerland	+ 0.8	Q1	+ 0.2	+ 0.8	+ 1.5	– 0.3	Q1	+ 3.2	Jun	3.6	Aug†	3.7
United States	+ 3.6	Q2	+ 3.3	+ 3.7	+ 3.3	+ 3.0	Jul	+ 7.5	Jul	4.9	Aug	5.4
Euro area	+ 1.1	Q2	+ 1.2	+ 1.3	+ 1.7	+ 0.3	Jun	nil	Jul	8.6	Jul	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.2	Q2	– 6.3	na	na	+ 0.7	Jul	+ 5.8	Jun	7.3	Jul†	7.8
Greece	+ 3.7	Q2	na	na	na	– 2.3	Jun	+ 3.9	Jun	9.9	Mar	10.8
Iceland	+ 2.9	Q1	na	na	na	na		na		2.1	Jun†	3.1
Ireland	+ 2.4	Q1	+ 1.0	na	na	+ 0.4	Jun	+ 3.4	Jun	4.3	Aug	4.4
Luxembourg	+ 3.1	Q1	na	na	na	+11.2	May	– 1.4	Jul	4.4	Jul†	4.0
New Zealand	+ 1.9	Q1	+ 1.5	na	na	+ 3.5	Q4	+ 5.9	Q2	3.7	Q2	4.0
Norway	– 0.8	Q1	+ 2.2	na	na	– 1.3	Jul	+ 3.7	Jun	4.7	Jul**	4.5
Portugal	+ 0.1	Q1	+ 0.8	na	na	+ 1.2	Jun	– 1.9	Jul	7.2	Q2†	6.3

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Apr-Jun; claimant count rate 2.8% in Jul. §EU harmonised rate 9.0% in Jul. **May-Jul.

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Prices and wages

Sep 8th 2005
From The Economist print edition

% change on year ago

	Consumer prices		The Economist poll consumer prices forecast		Producer prices		Wages/earnings	
	latest	year ago	2005	2006	latest	year ago	latest	year ago
Australia	+ 2.5 Q2	+ 2.5	+ 2.7	+ 2.7	+ 6.9 Q2	+ 2.8	+ 5.8 Q2	+ 3.0
Austria	+ 2.2 Jul	+ 2.2	+ 2.1	+ 1.8	+ 0.9 Aug	+ 6.3	+ 2.3 Jul	+ 2.0
Belgium	+ 3.1 Aug	+ 2.3	+ 2.4	+ 2.0	+ 1.8 Jul	+ 5.5	+ 2.6 Apr	+ 2.3
Britain	+ 2.3 Jul*	+ 1.4	+ 2.0	+ 1.9	+ 3.0 Jul	+ 2.6	+ 4.2 Jun†	+ 4.2
Canada	+ 2.0 Jul	+ 2.3	+ 2.1	+ 2.2	– 0.3 Jul	+ 5.5	+ 1.4 Jun	+ 2.5
Denmark	+ 2.0 Jul	+ 1.3	+ 1.6	+ 1.8	+ 4.7 Jul	+ 2.7	+ 2.9 Q2	+ 3.1
France	+ 1.7 Jul	+ 2.3	+ 1.8	+ 1.6	+ 2.9 Jun	+ 2.2	+ 2.9 Q2	+ 2.8
Germany	+ 1.9 Aug	+ 2.0	+ 1.7	+ 1.6	+ 2.5 Jul	+ 3.9	+ 0.9 Jun	+ 1.4
Italy	+ 2.0 Aug	+ 2.3	+ 2.1	+ 1.9	+ 3.6 Jul	+ 3.3	+ 2.8 Jul	+ 3.2
Japan	– 0.3 Jul	– 0.1	– 0.1	+ 0.3	+ 1.5 Jul	+ 1.7	+ 3.7 Jul	+ 1.7
Netherlands	+ 1.8 Aug	+ 1.1	+ 1.4	na	+ 5.6 Jul	+ 5.2	+ 0.8 Jul	+ 1.0
Spain	+ 3.3 Jul	+ 3.4	+ 3.2	+ 2.9	+ 4.6 Jul	+ 4.1	+ 2.5 Q1	+ 3.2
Sweden	+ 0.3 Jul	+ 0.7	+ 0.5	+ 1.3	+ 3.7 Jul	+ 1.9	+ 2.6 Jun	+ 1.6
Switzerland	+ 1.0 Aug	+ 1.0	+ 1.1	+ 1.1	+ 1.1 Jul	+ 1.3	+ 0.9 2004	+ 1.4
United States	+ 3.2 Jul	+ 3.0	+ 3.0	+ 2.7	+ 4.6 Jul	+ 4.0	+ 2.7 Aug	+ 2.2
Euro area	+ 2.1 Aug	+ 2.3	+ 2.1	+ 1.8	+ 4.0 Jul	+ 2.9	+ 3.1 Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.0 Jul	+ 0.3	na	na	+ 4.0 Jul	+ 1.5	+ 4.0 Q2	+ 3.8
Greece	+ 3.9 Jul	+ 2.9	na	na	+ 5.1 Jul	+ 4.7	na	na
Iceland	+ 3.7 Aug	+ 3.7	na	na	+ 4.3 Aug	+ 5.7	+ 6.6 Jul	+ 5.1
Ireland	+ 2.4 Jul	+ 2.7	na	na	+ 0.2 Jul	– 0.7	+ 6.4 Q1	+ 3.9
Luxembourg	+ 2.6 Jul	+ 2.4	na	na	+ 5.4 Jun	+ 9.2	+ 0.4 May	+ 2.4
New Zealand	+ 2.8 Q2	+ 2.4	na	na	+ 4.7 Q2	+ 1.5	+ 2.6 Q2	+ 2.3
Norway	+ 1.4 Jul	+ 1.5	na	na	+19.3 Jul	+13.9	+ 3.8 Q2	+ 4.1
Portugal	+ 2.2 Jul	+ 2.8	na	na	+ 4.0 Jul	+ 4.2	– 0.2 Jun	– 0.1

*RPI inflation rate 2.9% in Jul. †Apr-Jun.

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Economic forecasts

Sep 8th 2005
From The Economist print edition

The Economist poll of forecasters, September averages

(previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2005	2006	2005	2006	2005	2006	2005	2006
Australia	2.2/3.4	2.7/3.6	2.4 (2.3)	3.2 (3.1)	2.7	2.7 (2.6)	-5.9	-5.5 (-5.6)
Austria	1.7/2.3	1.5/2.2	1.9	2.0	2.1	1.8 (1.7)	-0.4(-0.3)	-0.3
Belgium	0.9/1.4	1.5/2.3	1.2	1.9	2.4 (2.3)	2.0 (1.8)	2.8 (2.9)	2.7 (2.8)
Britain	1.8/2.4	1.7/2.6	2.0 (2.1)	2.2 (2.1)	2.0 (1.9)	1.9	-2.4(-2.5)	-2.5(-2.6)
Canada	2.3/3.0	2.5/3.6	2.8 (2.7)	3.0	2.1	2.2	1.4 (1.3)	1.2
Denmark	1.7/2.3	1.8/2.5	2.0	2.2	1.6 (1.5)	1.8 (1.7)	2.1 (2.0)	1.9 (1.8)
France	1.1/1.7	1.3/2.4	1.4 (1.5)	1.8 (1.9)	1.8	1.6 (1.5)	-0.7	-0.5
Germany	0.3/1.2	1.0/1.6	0.9 (1.1)	1.3	1.7 (1.6)	1.6 (1.3)	3.6 (3.7)	3.4 (3.5)
Italy	-0.6/0.2	0.5/1.4	-0.2 (-0.1)	1.0 (1.2)	2.1	1.9	-1.3(-1.4)	-1.5
Japan	1.4/2.5	1.0/2.8	1.9 (1.7)	1.9 (1.7)	-0.1	0.3	3.4 (3.5)	3.3 (3.4)
Netherlands	0.1/1.2	0.8/2.1	0.5 (0.4)	1.6 (1.5)	1.4	na	3.7	3.6
Spain	2.8/3.5	2.2/3.2	3.2 (3.1)	2.8	3.2 (3.1)	2.9 (2.8)	-5.4	-5.5
Sweden	1.5/2.4	1.8/3.4	2.1 (1.9)	2.7 (2.6)	0.5	1.3	6.7 (5.7)	6.2 (5.2)
Switzerland	0.3/1.3	0.7/1.8	0.8	1.5	1.1	1.1	11.4(11.2)	11.0(10.8)
United States	3.5/4.4	2.5/5.1	3.7 (3.6)	3.3	3.0 (2.9)	2.7 (2.6)	-6.3	-6.3 (-6.2)
Euro area	1.0/1.4	1.3/1.9	1.3	1.7	2.1 (2.0)	1.8 (1.6)	0.3 (0.4)	0.2 (0.4)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, J.P. Morgan Chase, Morgan Stanley, Decision Economics, BNP Paribas, Royal Bank of Canada, Citigroup, Scotiabank, UBS

Every month, *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. The panel has raised its inflation forecasts for both the United States and the euro area. It expects American prices to rise by 3.0% in 2005 and 2.7% in 2006, up from 2.9% and 2.6% respectively last month. It predicts that euro-area prices will rise by 2.1% in 2005 and 1.8% in 2006, up from 2.0% and 1.6% respectively in August. The panel has become more optimistic about Japan, forecasting that GDP will grow by 1.9% in both 2005 and 2006. It has edged up its forecast for American growth to 3.7% this year.

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Money and interest rates

Sep 8th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Sep 7th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.5	+ 8.8	Jul	5.63	5.43	5.05	5.14	5.57	6.14
Britain	+ 4.9	+11.5	Jul	4.53	4.91	4.15	4.21	4.96	5.18
Canada	+ 6.5	+10.2	Jul	2.75	2.32	3.04	3.87	4.66	5.04
Denmark	+22.0	+15.7	Jul	2.20	2.25	2.15	3.03	4.22	4.86
Japan	+ 4.4	+ 1.7	Aug	0.02	0.02	0.14	1.30	1.62	1.39
Sweden	+ 3.6	+ 8.1	Jul	1.47	2.01	2.00	2.95	4.40	2.72
Switzerland	+ 0.5	+ 7.3	Jul	0.76	0.65	0.96	1.81	2.66	1.82
United States	+ 1.1	+ 5.0	Jul	3.63	1.78	3.86	4.13	4.16	5.08
Euro area†	+11.1	+ 7.9	Jul	2.13	2.12	2.14	3.07	4.10	3.32

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.25%, Japan No. 272 1.32%. Central bank rates: US fed funds 3.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Sep 8th 2005
From The Economist print edition

2000=100

	Aug 30th	Sep 6th*	% change on one month	% change on one year
Dollar index				
All items	131.7	134.5	+ 0.7	+10.8
Food	121.5	124.0	– 2.0	+ 6.5
Industrials				
All	144.9	148.1	+ 3.7	+15.9
Nfa†	128.5	135.3	+ 1.6	+ 1.5
Metals	153.8	155.0	+ 4.8	+24.2
Sterling index				
All items	111.9	110.7	– 2.5	+ 6.5
Euro index				
All items	99.9	99.7	– 0.4	+ 7.2
Yen index				
All items	136.3	137.0	– 1.4	+11.1
Gold				
$ per oz	430.55	443.95	+ 2.4	+11.3
West Texas Intermediate				
$ per barrel	69.87	65.81	+ 4.3	+52.2

* Provisional. † Non-food agriculturals.

Our commodity-price index was rebased in February 2005.

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Stockmarkets

Sep 8th 2005
From The Economist print edition

Market indices

	Sep 7th	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,456.3	4,462.7	3,905.5	+ 1.0	- 0.1	+ 9.9	+ 7.7
Austria (ATX)	3,329.5	3,334.0	2,415.0	+ 1.3	- 0.1	+36.9	+25.4
Belgium (Bel 20)	3,257.8	3,314.8	2,958.8	+ 1.0	-11.5	+11.1	+ 1.7
Britain (FTSE 100)	5,365.9	5,377.5	4,783.6	+ 1.3	-22.6	+11.5	+ 6.8
Canada (Toronto Composite)	10,806.8	10,813.3	9,006.2	+ 1.3	- 5.1	+16.9	+18.2
Denmark (KBX)	334.8	337.5	257.8	+ 1.2	- 0.8	+29.9	+18.6
France (SBF 250)	3,126.3	3,146.1	2,633.6	+ 1.9	-28.8	+18.7	+ 8.7
(CAC 40)	4,486.2	4,527.1	3,816.1	+ 2.0	-35.2	+17.4	+ 7.5
Germany (DAX)*	4,988.1	4,990.6	4,178.1	+ 3.3	-38.2	+17.2	+ 7.3
Italy (S&P/MIB)	34,092.0	34,092.0	30,645.0	+ 1.7	-32.0	+10.3	+ 1.0
Japan (Nikkei 225)	12,607.6	12,634.9	10,825.4	+ 1.6	-67.6	+ 9.7	+ 2.1
(Topix)	1,285.5	1,290.6	1,109.2	+ 1.1	-55.4	+11.8	+ 4.1
Netherlands (AEX)	394.3	401.6	347.0	+ 1.2	-43.8	+13.3	+ 3.7
Spain (Madrid SE)	1,124.2	1,124.2	950.9	+ 4.0	- 1.9	+17.2	+ 7.3
Sweden (Affarsvarlden Gen)	261.6	263.6	218.9	+ 1.9	-34.7	+18.2	+ 5.1
Switzerland (Swiss Market)	6,684.9	6,689.2	5,669.6	+ 2.6	-20.5	+17.4	+ 7.7
United States (DJIA)	10,633.5	10,940.6	10,012.4	+ 1.4	- 9.3	- 1.4	- 1.4
(S&P 500)	1,236.4	1,245.0	1,137.5	+ 1.3	-19.1	+ 2.0	+ 2.0
(NASDAQ Comp)	2,172.0	2,218.2	1,904.2	+ 0.9	-57.0	- 0.2	- 0.2
Europe (FTSEurofirst 300)†	1,205.0	1,205.0	1,038.6	+ 2.4	-29.3	+15.7	+ 5.9
Euro area (FTSE Euro 100)†	1,021.7	1,026.7	894.4	+ 2.4	-34.1	+13.4	+ 3.9
World (MSCI)‡	1,220.6	1,220.6	1,115.0	+ 2.2	-15.8	+ 4.4	+ 4.4
World bond market (Citigroup)††	650.8	662.3	626.9	+ 0.9	- 1.7	- 2.3	- 2.3

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Sep 8th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		Current-account balance The Economist poll % of GDP, forecast 2005	Current-account balance The Economist poll % of GDP, forecast 2006	Exchange rate trade-weighted† 2000=100 Sep 7th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Sep 7th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2005‡
Australia	– 16.5	Jul	– 43.1	Q2	– 5.9	– 5.5	117.4	107.7	1.30	1.44	2.39	1.62	1.18	+ 0.9
Austria	– 1.5	Jun	nil	Jun	– 0.4	– 0.3	103.9§	104.0	0.80	0.82	1.48	–	0.73	– 2.0
Belgium	+ 15.1	Jun	+ 12.2	Mar	+ 2.8	+ 2.7	104.4§	104.4	0.80	0.82	1.48	–	0.73	– 0.5
Britain	–111.2	Jun	– 44.0	Q1	– 2.4	– 2.5	100.5	99.8	0.54	0.56	–	0.68	0.49	– 2.9
Canada	+ 46.2	Jun	+ 16.3	Q2	+ 1.4	+ 1.2	121.6	111.8	1.18	1.29	2.18	1.47	1.08	+ 1.2
Denmark	+ 11.5	Jul	+ 11.5	Jul	+ 2.1	+ 1.9	105.8	105.9	5.99	6.13	11.0	7.46	5.44	+ 1.8
France	– 26.4	Jun	– 22.6	Jun	– 0.7	– 0.5	106.9§	107.0	0.80	0.82	1.48	–	0.73	– 3.0
Germany	+198.8	Jul	+110.5	Jul	+ 3.6	+ 3.4	104.6§	104.7	0.80	0.82	1.48	–	0.73	– 3.5
Italy	– 6.1	Jun	– 23.7	Jun	– 1.3	– 1.5	76.5§	76.6	0.80	0.82	1.48	–	0.73	– 4.4
Japan	+113.2	Jun	+166.0	Jun	+ 3.4	+ 3.3	85.9	87.9	110	109	203	137	–	– 6.1
Netherlands	+ 40.9	Jun	+ 28.3	Q2	+ 3.7	+ 3.6	103.9§	103.9	0.80	0.82	1.48	–	0.73	– 2.2
Spain	– 89.4	Jun	– 72.6	May	– 5.4	– 5.5	77.2§	77.2	0.80	0.82	1.48	–	0.73	+ 0.5
Sweden	+ 22.2	Jul	+ 27.9	Q2	+ 6.7	+ 6.2	96.4	98.6	7.48	7.51	13.8	9.31	6.79	+ 0.8
Switzerland	+ 7.1	Jul	+ 40.2	Q1	+11.4	+11.0	107.3	107.2	1.24	1.27	2.28	1.54	1.13	– 1.0
United States	–723.4	Jun	–717.0	Q1	– 6.3	– 6.3	84.1	86.8	–	–	1.84	1.24	0.91	– 4.1
Euro area	+ 61.5	Jun	+ 16.1	Jun	+ 0.3	+ 0.2	116.2	115.2	0.80	0.82	1.48	–	0.73	– 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.1	Jun	+ 6.0	Jun	na	na	81.5§	81.6	0.80	0.82	1.48	–	0.73	+ 1.3
Greece	– 33.6	Jun	– 15.5	Jun	na	na	59.9§	59.9	0.80	0.82	1.48	–	0.73	– 3.8
Iceland	– 1.0	Jul	– 1.6	Q2	na	na	102.8**	95.4	62.1	72.3	114	77.3	56.4	+ 1.1
Ireland	+ 40.2	Jun	– 3.1	Q1	na	na	94.1§	94.0	0.80	0.82	1.48	–	0.73	– 0.7
Luxembourg	– 4.4	Jun	+ 3.0	Q1	na	na	104.4§	104.4	0.80	0.82	1.48	–	0.73	– 0.8
New Zealand	– 3.7	Jul	– 7.0	Q1	na	na	136.5	128.4	1.42	1.55	2.61	1.77	1.29	+ 3.2
Norway	+ 41.2	Jul	+ 40.8	Q2	na	na	112.1	104.2	6.26	6.87	11.5	7.79	5.69	+ 14.4
Portugal	– 22.3	Jun	– 15.7	Jun	na	na	94.1**	93.6	0.80	0.82	1.48	–	0.73	– 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, July average. ‡OECD forecast. **IMF, May average.

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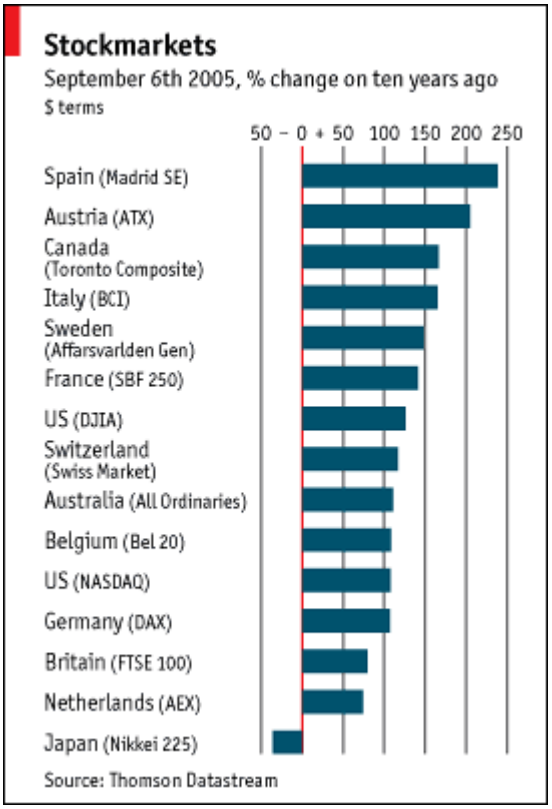
Stockmarkets

Sep 8th 2005
From The Economist print edition



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Overview

Sep 8th 2005
From The Economist print edition

Thailand's GDP growth quickened to 4.4% in the year to the second quarter, surpassing expectations. Tourism has rebounded after the tsunami of last year, with foreign arrivals increasing by 1.9% in the year to the second quarter. Manufacturing was also strong, but high oil prices pose a threat to growth in the months ahead.

Inflation remains strong in **Argentina**, where consumer prices rose by 9.7% in the year to August, and in **Venezuela**, where they rose by 14.8%. **Peru**, by contrast, is enjoying remarkable price stability. Inflation was just 1.2% in the year to August.

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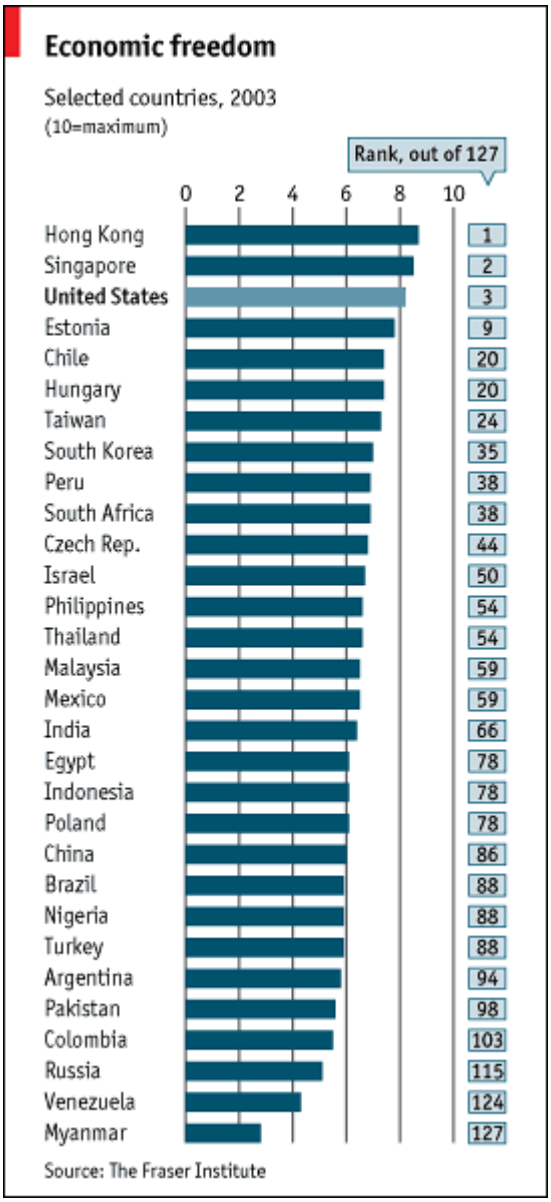
Economic freedom

Sep 8th 2005
From The Economist print edition

Hong Kong enjoys the most economic freedom of any of the 127 countries or territories in the Economic Freedom of the World Index, created by the Fraser Institute, a Canadian think-tank. The index measures how far a country's policies and institutions support property rights, personal choice and competition. The index also favours sound money and small government. Plucky Estonia ranks ninth, while Venezuela ranks only a few places above the trammelled economy of Myanmar.



Economy

Sep 8th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q2	+16.1	Jul	+ 1.8	Jul	+87.6	Jul	+68.7	2004	711.0	Jun
Hong Kong	+ 6.8	Q2	– 0.6	Q1	+ 1.3	Jul	– 9.6	Jul	+18.5	Q1	122.3	Aug
India	+ 7.0	Q1	+11.7	Jun	+ 4.1	Jul	–33.0	Jul	– 6.4	Q1	133.6	Aug
Indonesia	+ 5.5	Q2	+10.1	Mar	+ 8.3	Aug	+27.8	Jul	+ 7.8	Q1	32.6	Jun
Malaysia	+ 4.1	Q2	+ 0.9	Jul	+ 3.0	Jul	+23.6	Jul	+16.7	Q1	78.0	Jul
Philippines	+ 4.8	Q2	– 0.1	Jun	+ 7.2	Aug	– 0.8	Jun	+ 2.9	Mar	15.3	Aug
Singapore	+ 5.2	Q2	+ 5.9	Jul	+ 0.1	Jul	+16.9	Jul	+32.5	Q2	116.4	Aug
South Korea	+ 3.3	Q2	+ 7.0	Jul	+ 2.0	Aug	+26.0	Aug	+21.3	Jul	205.6	Jul
Taiwan	+ 3.0	Q2	– 1.1	Jul	+ 3.6	Aug	+ 1.7	Aug	+13.3	Q2	254.1	Aug
Thailand	+ 4.4	Q2	+ 4.7	Jul	+ 5.6	Aug	– 7.3	Jul	– 2.2	Jul	47.3	Jul
Argentina	+ 8.0	Q1	+ 6.0	Jul	+ 9.7	Aug	+11.2	Jul	+ 2.8	Q1	22.3	Jun
Brazil	+ 3.9	Q2	+ 6.3	Jun	+ 6.6	Jul	+40.1	Aug	+13.4	Jul	59.4	Jun
Chile	+ 6.5	Q2	+ 4.4	Jul	+ 3.1	Jul	+ 8.7	Aug	+ 0.6	Q2	16.2	Jul
Colombia	+ 3.6	Q1	+ 3.0	Jun	+ 4.9	Aug	+ 1.6	May	– 0.8	Q1	13.7	Jul
Mexico	+ 3.1	Q2	+ 0.7	Jun	+ 4.5	Jul	– 9.6	Jul	– 8.4	Q2	65.6	Jun
Peru	+ 4.6	Jun	+ 5.9	Jun	+ 1.2	Aug	+ 3.8	Jun	+ 0.4	Q2	14.5	Jul
Venezuela	+11.1	Q2	+10.4	May	+14.8	Aug	+24.7	Q2	+17.7	Q2	23.1	Jun
Egypt	+ 4.7	Q4	+ 3.3	2004†	+ 4.7	Jun	– 9.5	Q1	+ 4.4	Q1	18.5	Jul
Israel	+ 4.8	Q2	+ 0.5	Jun	+ 1.6	Jul	– 8.0	Jul	+ 1.9	Q1	24.5	Jul
South Africa	+ 4.5	Q2	+ 2.3	Jun	+ 3.4	Jul	– 2.3	Jul	– 8.5	Q1	17.2	Aug
Czech Republic	+ 4.4	Q1	+11.2	Jul	+ 1.7	Aug	+ 1.3	Jul	– 4.1	Q2	30.2	Aug
Hungary	+ 4.1	Q2	+ 6.5	Jun	+ 3.7	Jul	– 2.7	Q1	– 9.2	Q1	17.7	Jul
Poland	+ 2.8	Q2	+ 2.6	Jul	+ 1.3	Jul	– 3.4	Jun	– 0.2	Jun	39.4	Jul
Russia	+ 5.2	Q1	+ 4.9	Jul	+12.5	Jul	+106.9	Jun	+69.2	Q1	140.9	Jul
Turkey	+ 4.8	Q1	– 0.3	Jul	+ 7.9	Aug	–38.9	Jul	–19.3	Jun	40.0	Jun
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.0	Q2	+11.1	Jul	+ 4.2	Aug	– 2.3	Jun	– 1.3	Jun	1.7	Jun
Latvia	+11.6	Q2	+ 9.0	Jun	+ 6.1	Aug	– 2.7	Jun	– 1.5	Jun	2.1	Jul
Lithuania	+ 8.2	Q2	na		+ 1.8	Jul	– 3.2	Jun	– 1.5	Q1	3.4	Jul
Slovakia	+ 5.1	Q2	+ 4.7	Jul	+ 2.0	Jul	– 2.0	Jun	– 2.3	May	15.3	Jul
Slovenia	+ 2.6	Q1	+ 1.0	Jun	+ 2.0	Aug	– 1.3	Jun	nil	Jun	8.1	Jun
Pakistan	+ 8.4	2005†	+13.6	Apr	+ 9.0	Jul	– 6.7	Jul	– 1.5	Q2	10.4	May
Saudi Arabia	+ 5.2	2004	na		+ 0.6	Jun	+84.9	2004	+51.5	2004	24.8	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group.

Financial markets

Sep 8th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Sep 7th		Dec 31st 2004	
	Sep 7th	year ago	Sep 7th	% a year		one week	in local currency	in $ terms
China	8.09	8.28	14.9	4.38	1,255.0	+2.7	– 5.7	– 3.5
Hong Kong	7.77	7.80	14.3	3.75	15,224.6	+2.2	+ 7.0	+ 7.1
India	43.8	46.3	80.6	5.19	7,946.8	+1.8	+ 20.4	+ 19.4
Indonesia	10,410	9,305	19,150	15.14	1,059.4	+0.9	+ 5.9	– 5.6
Malaysia	3.77	3.80	6.93	2.91	919.1	+0.6	+ 1.3	+ 2.1
Philippines	56.1	56.1	103.2	8.63	1,897.3	–2.0	+ 4.1	+ 4.2
Singapore	1.68	1.70	3.09	2.06	2,296.9	+0.9	+ 11.2	+ 8.1
South Korea	1,027	1,150	1,888	3.55	1,143.0	+5.5	+ 27.6	+ 28.7
Taiwan	32.6	33.9	60.0	1.45	6,141.1	+1.8	nil	– 2.9
Thailand	41.0	41.6	75.4	3.60	708.5	+1.5	+ 6.0	+ 0.5
Argentina	2.91	2.99	5.35	6.69	1,608.0	+1.7	+ 16.9	+ 19.6
Brazil	2.33	2.90	4.29	19.73	28,854.0	+2.9	+ 10.1	+ 25.6
Chile	541	621	995	3.72	9,718.8	–0.4	+ 8.4	+ 11.4
Colombia	2,281	2,536	4,195	6.96	7,003.5	+4.4	+ 61.2	+ 66.2
Mexico	10.7	11.6	19.7	9.36	15,246.2	+7.0	+ 18.0	+ 22.9
Peru	3.29	3.37	6.06	2.90	4,741.2	+2.8	+ 27.8	+ 27.3
Venezuela	2,575§	2,601§	4,737	11.20	20,821.1	+5.7	– 30.5	– 30.4
Egypt	5.77	6.24	10.62	9.20	44,610.1	+5.2	+ 81.5	+ 90.8
Israel	4.50	4.51	8.28	3.63	730.0	+2.1	+ 13.4	+ 8.8
South Africa	6.35	6.65	11.7	7.05	15,939.9	+3.4	+ 25.9	+ 11.8
Czech Republic	23.5	26.2	43.2	1.79	1,353.9	+0.2	+ 31.2	+ 24.6
Hungary	196	205	361	5.92	21,886.5	+1.5	+ 48.5	+ 36.7
Poland	3.17	3.62	5.82	4.55	31,893.7	+1.7	+ 19.7	+ 13.3
Russia	28.2	29.2	52.0	13.00	866.6‡	–1.8	+ 43.8	+ 41.1
Turkey	1.33	1.50	2.45	15.80	31,385.0	+1.5	+ 25.7	+ 27.0
EM (MSCI)*	1.00	1.00	1.84	na	628.2	+3.6	+ 15.9	+ 15.9
EMBI+†	1.00	1.00	1.84	na	354.8	+0.2	+ 7.6	+ 7.6

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group.

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